tions of Section 5(a)(1), 5(a)(2) and 5(c) of the Securities Act of 1933, as amended, 15 U.S.C. 77e(a)(1), 77e(a)(2) and 77e(c), and has engaged and is about to engage in acts and practices which constitute and will constitute violations of Section 7(b) of the Investment Company Act of 1940, 15 U.S.C. 80a–7(b). The Commission, pursuant to Section 20(b) of the Securities Act of 1933, 15 U.S.C. 77t(b), and Section 42(e) of the Investment Company Act of 1940, 15 U.S.C. 80a–41(e), brings this action to enjoin such acts and practices.

3. This court has jurisdiction of this action under Section 22(a) of the Securities Act of 1933, 15 U.S.C. 77v(a), and Section 44 of the Investment Company Act of 1940, 15 U.S.C. 80a–43.

4. The defendant is a corporation organized under the laws of the State of Nebraska which is qualified to do business and is doing business in the District of Columbia, and which maintains a place of business in the District of Columbia.

Count One

(Section 5(a)(1) of the Securities Act of 1933, as amended, 15 U.S.C. 77(e)(a)(1)).

5. Defendant is, directly or indirectly, making use of the mails and means or instruments of transportation and communications in interstate commerce to sell securities, namely, shares, interests or participations in a fund or pool of securities managed by defendant and known as the Flexible Fund A account of the United Benefit Life Insurance Company (hereinafter sometimes referred to as "the Flexible Fund").

6. The Flexible Fund is an unincorporated fund created pursuant to Chapter 217 of the laws of Nebraska, effective March 22, 1961. (Sections 44–310.06 through 44–310.08 of the Reissue Revised Statutes of Nebraska 1943, 1961 Cumulative Supplement.)

7. The Flexible Fund is engaged primarily and proposes to engage primarily in the business of investing, reinvesting and trading in securities.

8. The Flexible Fund is engaged and proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns and proposes to acquire investment securities having a value exceeding 40 percentum of the value of its total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

9. The Flexible Fund is issuing and proposes to issue securities, namely, shares, interests or participations in the Flexible Fund, which are described more fully in paragraphs 10 through 14 of this complaint.

10. Said shares, interests or participations in the Flexible Fund are represented by and described in a document which purports to be an annuity policy, a copy of which is marked "Exhibit A" and attached hereto as a part of this complaint, and are offered for sale to the public by the defendant by means of a prospectus, a copy of which is marked "Exhibit B" and attached hereto as a part of this complaint.

11. The document marked "Exhibit A" and the prospectus marked "Exhibit B" are each published and publicly disseminated by or at the instance and on behalf of the defendant.

12. The documents marked "Exhibit A" and "Exhibit B" represent, describe and offer for sale a security, the terms of which are as follows:

12(a) each purchaser of such security pays specified dollar amounts to the defendant on a periodic basis;

12(b) the defendant deducts its sales commission and other charges from such payments, and credits the net dollar balances to the Flexible Fund;

12(c) the assets of the Flexible Fund, including the balances described in paragraph 12(b) of this complaint and the securities and other assets acquired therewith, are held, invested and managed by the defendant for the benefit of purchasers of shares, interests or participations in the Flexible Fund;

12(d) the defendant will provide to the Flexible Fund, and the purchasers of such security will receive the benefit

of "full-time professional investment management";

12(e) the defendant will manage the Flexible Fund and apply an "investment policy" under which (i) the "major part" of the assets of the Flexible Fund will be invested by the defendant for the Fund in common stocks "chosen for high quality with emphasis on those having strong potential for long-term growth in earnings and values"; (ii) the investments will be diversified among different companies and industries, (iii) "dollar cost averaging" principles will be applied, (iv) investments will be continually reviewed and changed "when desirable or necessary" and (v) the assets of the Fund will be "kept fully invested";

12(f) each purchaser of such security acquires through his payments a proportionate share, interest or participation in the pool of securities, the Flexible Fund, managed by the defendant;

12(g) each purchaser's proportionate share, interest or participation in the Flexible Fund is subject to a monthly charge for investment management and mortality costs which is stated to be 83/1000 of 1% (equivalent to approximately 1% per year) and is diminished by that amount;

12(h) each purchaser's proportionate share, interest or participation in the Flexible Fund is credited by the defendant with additional dollar amounts representing the purchaser's proportionate share of any income on the securities held for the Flexible Fund, which amounts depend upon the performance of the Fund's portfolio and will be affected directly by defendant's management of the Flexible Fund;

12(i) each purchaser's proportionate share, interest or participation in the Flexible Fund is credited by the defendant with additional dollar amounts representing the purchaser's proportionate share of any capital gains, realized or unrealized, and debited by the defendant with dollar amounts representing the purchaser's proportionate share of any capital losses, realized or unrealized, on the securities held for the Flexible Fund, which amounts depend upon the performance of the Fund's portfolio and

will be affected directly by the defendant's management of the Flexible Fund;

12(j) each purchaser has the right, at his election at any time, to have paid to him in cash by the defendant from the assets of the Flexible Fund his proportionate share, interest, or participation in the Flexible Fund, including his proportionate share of any net income and net capital gains or losses, realized or unrealized, on the securities held for the Flexible Fund;

12(k) on a date specified in "Exhibit A" and referred to therein as the "Maturity Date" each purchaser has the right to have all sums standing to his credit in the Flexible Fund paid to him in cash, or, at his election, applied to the purchase from the defendant of an annuity computed on the basis of his age at that time. In effect, then, the purchaser simply redeems his interest in the investment company and purchases an annuity from the insurance company with the proceeds.

13. The nature of an interest, share or participation in the Flexible Fund whereby the purchaser participates in the investment experience of the Flexible Fund is such that the provisions of the Securities Act of 1933 and the Investment Company Act of 1940 and the Rules, Regulations and Forms thereunder are pertinent thereto and the application of the provisions of said Acts is necessary to adequately protect investors to whom the security is offered for sale and sold.

14. The prospectus marked "Exhibit B" omits to state material facts with respect to the matters set forth in paragraphs 14(a) through 14(l) inclusive, which facts are necessary in order to enable the persons to whom an interest, share or participation in the Flexible Fund is offered for sale and sold to make informed judgments with respect thereto.

14(a) The prospectus sets forth charts which show the value as of December 31, 1961 of a deposit of $100 per month since January 1, 1937 in a fund accumulated according to the Dow-Jones Industrial Averages, but fails

to disclose that the charts relate to and reflect the composite average produced by the fluctuation of market prices (performance) of a certain number of shares of a certain group of common stocks, whereas:

(i) the Flexible Fund includes or may include securities other than common stocks;

(ii) the Flexible Fund does not include or may not include all of the common stocks included in the group whose performance is reflected in the charts;

(iii) the Flexible Fund does not include or may not include holdings in such common stocks in the same proportions as the group of stocks whose performance is reflected in the charts; and

(iv) the Flexible Fund includes or may include common stocks other than those included in the group whose performance is reflected in the charts.

14(b) The prospectus represents that a Flexible Fund Annuity provides the three steps necessary to build a balanced and adequate estate, namely, (i) savings, (ii) insurance, and (iii) investment, and in that order, whereas, in fact, the Flexible Fund Annuity is not a savings vehicle and does not provide death benefit guarantees traditionally found in life insurance policies, but is primarily and predominantly a vehicle for investments in securities.

14(c) The prospectus states that the purchaser's payments are "savings" whereas, in fact, such payments are subjected to the risks of investments in common stock and other securities, and these risks are borne in substantial part by the purchaser since there is no promise that the payments will be returned to him undiminished.

14(d) The prospectus states that, "The Flexible Fund Annuity is unique because it combines the *opportunity* to share in the growth of our economy with the traditional *guarantees* inherent in life insurance policies." (underlining indicates italics in material quoted), but fails to state what guarantees, if any, traditionally inherent in life insurance policies are included in the Flexible Fund Annuity and what traditional life insurance guarantees are not included.

14(e) The prospectus states that, "And most important, your Flexible Fund Annuity has certain guaranteed values similar to other life insurance policies.", implying that the Flexible Fund Annuity is a life insurance policy, whereas, in fact, the Flexible Fund Annuity is not a life insurance policy and the payment upon the death of a purchaser of a Flexible Fund Annuity is not similar to death benefits traditionally guaranteed in life insurance policies.

14(f) The prospectus emphasizes to the purchaser the possibility, indeed the probability, of gain on his investment while inadequately disclosing the risks he will bear.

14(g) The prospectus states that, "Because capital gains, as well as earnings, are retained in the Fund, there is *no tax* to the policy-owner during the accumulation period", and that, "After allowance for Company income taxes, a monthly charge of only 83/1000 of 1% of the Fund is made to provide for investment management and mortality costs." (underlining indicates italics in material quoted), giving an impression that favorable tax benefits accrue to the purchaser from his participation in the Flexible Fund. The prospectus fails to disclose or does not adequately disclose (i) the tax status of the Flexible Fund with respect to federal and state income taxes, (ii) the tax status of the defendant company with respect to federal and state income taxes, (iii) the effect that defendant's tax status will have on the Flexible Fund, (iv) that under present tax laws, taxes on capital gains realized by the Flexible Fund are paid currently by defendant and charged against the Flexible Fund, with the result that the amount of such earnings retained by the Flexible Fund and available for crediting to the accounts of purchasers is thereby reduced, and (v) that the total expenses of the Flexible Fund, including taxes, may be materially more than a monthly charge of 83/1000 of 1%.

14(h) The prospectus states under the caption, "INVESTMENT POLICY", that:

> "The investment policy applied to the Flexible Fund is based on a proper balance of growth and stability —safety and income. The over-all philosophy is to

provide maximum return—combining value and income—with maximum safety.

"It is our policy to invest as much as possible in common stocks consistent with the above philosophy; that is, the major part in common stocks and the smaller part in fixed rate investments. The ratio of common stocks to total investments may increase or decrease from time to time as conditions dictate."

The prospectus does not disclose: (i) what is meant by the phrase "proper balance of growth and stability"; (ii) the approximate percentage of the total assets of the Flexible Fund to be placed in common stocks, and in preferred stocks and debt securities; (iii) the limitations, if any, on the defendant's discretion to vary such percentages; and (iv) the criteria to be followed by the defendant in determining increases or decreases in such percentages.

14(i) The prospectus states that the purchaser of a participation in the Flexible Fund will obtain the advantages of the "dollar cost averaging" method of investing, but fails to disclose the disadvantages and risks inherent in the "dollar cost averaging" method of investing.

14(j) The prospectus, having described the advantages of "dollar cost averaging", states that the defendant will employ "dollar cost averaging" in making investments for the Flexible Fund, but fails to disclose the disadvantages and risks inherent in that investment method and does not disclose upon what basis and to what extent "dollar cost averaging" will be followed in the management of the portfolio of the Flexible Fund.

14(k) The prospectus states that "investments are diversified among different companies and industries", but fails to state: (i) the maximum percentage of the assets of the Flexible Fund which may be invested in securities issued by companies of any one industry or group of industries; and (ii) the maximum percentage of the assets of the Flexible Fund which may be invested in the securities of any one issuer;

14(l) The prospectus states that the defendant has "assets in excess of $400,000,000", but fails to disclose adequate information concerning the financial status of the Flexible Fund. The prospectus does not set forth financial statements of the Flexible Fund, including a statement showing per share income and capital changes for a share outstanding throughout the year, a balance sheet or statement of assets and liabilities listing the securities held in the portfolio of the Flexible Fund showing their cost and value, a statement of income and expense and realized and unrealized gain or loss on investments, a statement showing the ratio of total operating and management expenses to total investment income, and a statement of changes in net assets of the Flexible Fund, prepared in accordance with generally accepted accounting principles and certified to by an independent Certified Public Accountant.

15. No registration statement under the Securities Act of 1933, as amended, is in effect with respect to the securities being issued by the Flexible Fund and offered for sale and sold to the public by the defendant.

Count Two

(Section 5(a)(2) of the Securities Act of 1933, as amended, 15 U.S.C. 77e(a)(2)).

16. Paragraphs 6 through 14 inclusive of this complaint are realleged and incorporated herein.

17. The defendant is, directly or indirectly, causing or about to cause the securities being issued by the Flexible Fund and offered for sale and sold to the public by the defendant to be carried through the mails or in interstate commerce for the purpose of sale or delivery after sale.

18. No registration statement under the Securities Act of 1933, as amended, is in effect with respect to such securities.

Count Three

(Section 5(c) of the Securities Act of 1933, as amended, 15 U.S.C. 77e(c)).

19. Paragraphs 6 through 14 inclusive of this complaint are realleged and incorporated herein.

20. The defendant is, directly or indirectly, making or about to make use of the mails and means or instruments of transportation and communication in interstate commerce to offer to sell through the use or medium of a prospectus or otherwise the securities being issued by the Flexible Fund and offered for sale and sold by the defendant.

21. No registration statement under the Securities Act of 1933, as amended, has been filed as to such securities.

Count Four

(Section 7(b) of the Investment Company Act of 1940, 15 U.S.C. 80a-7(b).

22. The Flexible Fund is an unincorporated fund created pursuant to Chapter 217 of the laws of Nebraska, effective March 22, 1961. (Sections 44-310.06 through 44-310.08 of the Reissue Revised Statutes of Nebraska 1943, 1961 Cumulative Supplement.)

23. The Flexible Fund is engaged primarily and proposes to engage primarily in the business of investing, reinvesting and trading in securities.

24. The Flexible Fund is engaged and proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns and proposes to acquire investment securities having a value exceeding 40 percentum of the value of its total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

25. The Flexible Fund does not have a board of directors.

26. The Flexible Fund is issuing and proposes to issue

securities, namely, shares, interests or participations in the Flexible Fund which are described in paragraphs 10 through 14 of this complaint.

27. The defendant is the depositor of and underwriter for an investment company, namely, the Flexible Fund.

28. The defendant is engaged and is about to engage, directly or indirectly, by use of the mails and means or instrumentalities of interstate commerce:

(a) in offering for sale, selling and delivering after sale, securities and interests in securities of which the Flexible Fund is the issuer, namely, securities described in paragraphs 10 through 14 of this complaint;

(b) in purchasing, redeeming, or otherwise acquiring securities and interests in securities of which the Flexible Fund is the issuer, namely, securities described in paragraphs 10 through 14 of this complaint;

(c) in selling or purchasing securities and interests in securities for the account of or on behalf of the Flexible Fund.

29. The Flexible Fund is not registered with the Securities and Exchange Commission as an investment company in accordance with Section 8 of the Investment Company Act of 1940, 15 U.S.C. 80a-8, and is not exempt under Section 6 of that Act.

Count Five

(Section 5(a)(1) of the Securities Act of 1933, as amended, 15 U.S.C. 77e(a)(1)).

30. The defendant is, directly or indirectly, making use of the mails and means or instruments of transportation and communication in interstate commerce to sell securities, namely, guarantees of the securities issued by the Flexible Fund which are described in paragraphs 10 through 14 of this complaint, which guarantees are in themselves securities being issued by the defendant.

31. Said guarantees of the securities issued by the Flexi-

ble Fund are described in the prospectus marked "Exhibit B", which states, in part, as follows:

> "To lessen the impact of any unusual, prolonged downward trend of the stock market, United of Omaha guarantees that after premiums have been paid for 10 full years *the value of a Flexible Fund Annuity policy can never be less than the sum of the net premiums invested in the fund.*
>
> • • • • • •
>
> "Regardless of the value [at the time a purchaser stops his plan] United of Omaha guarantees that the value of his policy can never be less than the following percentages of the *net premiums:*

Premiums Paid For	
one full year	50%
two full years	55%
three full years	60%
four full years	65%
five full years	70%
six full years	75%
seven full years	80%
eight full years	85%
nine full years	90%
ten full years	100%"

(Underlining indicates italics in material quoted.)

Since the net premium is explained in the prospectus ("Exhibit B") as the balance of the regular premium after deductions for sales and service charges and is defined in both "Exhibit A" and "Exhibit B" as 50% of the regular policy premium in the first policy year, 90.5% of the regular policy premiums in the second through the tenth policy years, and 95% of regular policy premiums in the eleventh and subsequent years, the defendant's guarantee of minimum values actually promises repayment of only the following percentages of the *total* premiums paid to the defendant:

Total premiums paid	Guarantees expressed as a percent of total premiums
1 full year	25.0
2 full years	38.6
3 " "	46.2
4 " "	52.2
5 " "	57.7
6 " "	62.8
7 " "	67.8
8 " "	72.6
9 " "	77.4
10 " "	86.5
11 " "	87.2
12 " "	87.9
13 " "	88.4
14 " "	88.9
15 " "	89.3
16 " "	89.7
17 " "	90.0
18 " "	90.3
19 " "	90.5
20 " "	90.7

As a result of the influence of the lower net premiums during the first ten policy years, no matter how long the pay-in period may be, the guaranteed amount can never attain as much as 95% of the total premiums paid.

32. Said guarantees by the defendant of the securities issued by the Flexible Fund are also described in and are represented by the document marked "Exhibit A".

33. The document marked "Exhibit A" and the prospectus marked "Exhibit B" are each published and publicly disseminated by or at the instance and on behalf of the defendant.

34. The prospectus marked "Exhibit B" omits to state material facts with respect to the matters set forth in paragraphs 34(a) and 34(b), which facts are necessary in order to enable persons to whom a guarantee of the security issued by the Flexible Fund is offered for sale and sold to make informed judgments with respect thereto.

34(a) The prospectus states that the defendant guarantees certain minimum values of each purchaser's interest in the Flexible Fund during the accumulation period, but

fails to disclose whether, and the extent to which, assets of the defendant have been segregated for the purpose of such guarantee and whether, and the extent to which, other obligations of the defendant have equal or prior claim on defendant's assets.

34(b) The prospectus states that, "The Flexible Fund Annuity is backed by the reputation and the resources of United of Omaha . . .", that defendant guarantees the minimum values and has "assets in excess of $400,000,000," but fails to set forth financial statements of defendant, including a balance sheet or statement of assets and liabilities, and an income statement for the latest fiscal year prepared in accordance with generally accepted accounting principles and certified to by an independent Certified Public Accountant.

35. No registration statement under the Securities Act of 1933, as amended, is in effect with respect to the securities being issued and offered for sale and sold to the public by the defendant.

Count Six

(Section 5(a)(2) of the Securities Act of 1933, as amended, 15 U.S.C. 77e(a)(2)).

36. Paragraphs 31 through 34 inclusive of this complaint are realleged and incorporated herein.

37. The defendant is, directly or indirectly, causing or about to cause the securities described in paragraphs 31 through 34 of this complaint to be carried through the mails or in interstate commerce for the purpose of sale or delivery after sale.

38. No registration statement under the Securities Act of 1933, as amended, is in effect with respect to such securities.

Count Seven

(Section 5(c) of the Securities Act of 1933, as amended, 15 U.S.C. 77e(c)).

39. Paragraphs 31 through 34 inclusive of this complaint are realleged and incorporated herein.

40. The defendant is, directly or indirectly, making or about to make use of the mails and means or instruments of transportation and communication in interstate commerce to offer to sell through the use or medium of a prospectus or otherwise the securities described in paragraphs 31 through 34 of this complaint.

41. No registration statement under the Securities Act of 1933, as amended, has been filed as to such securities.

* * * * * *

42. The defendant United Benefit Life Insurance Company will, unless restrained and enjoined, continue to engage in the acts and practices set forth in this complaint.

WHEREFORE, the plaintiff prays that this Court:

1. Grant a preliminary and final injunction restraining and enjoining the defendant, its officers, directors, agents, servants, employees, successors and assigns, and each of them, from directly or indirectly:

(a) making use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell the securities referred to and described in paragraphs 10 through 14 and 31 through 34 of this complaint, and any similar securities, through the use or medium of any prospectus or otherwise, unless and until registration statements under the Securities Act of 1933, as amended, are in effect with the Securities and Exchange Commission as to such securities; or

(b) carrying or causing to be carried through the mails or in interstate commerce, by any means or in-

struments of transportation, the securities referred to and described in pragraphs 10 through 14 and 31 through 34 of this complaint, and any similar securities, for the purpose of sale or for delivery after sale unless and until registration statements under the Securities Act of 1933, as amended, are in effect with the Securities and Exchange Commission as to such securities; or

(c) carrying or causing to be carried through the mails or in interstate commerce the securities referred to and described in paragraphs 10 through 14 and 31 through 34 of this complaint, and any similar securities, for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of Section 10 of the Securities Act of 1933, as amended, 15 U.S.C. 77e(b)(2); or

(d) making use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell the securities referred to and described in paragraphs 10 through 14 and 31 through 34 of this complaint, and any similar securities, through the use or medium of any prospectus or otherwise, unless and until registration statements under the Securities Act of 1933, as amended, are filed with the Securities and Exchange Commission as to such securities.

2. Grant a preliminary and final injunction restraining and enjoining the defendant, its officers, directors, agents, servants, employees, successors and assigns, and each of them, from directly or indirectly, by use of the mails or any means or instrumentality of interstate commerce;

(a) offering for sale, selling, or delivering after sale, any security or any interest in a security issued by the fund known as the Flexible Fund A Account of United Benefit Life Insurance Company, or any other similar investment company created under the laws of the United States or of a State, of which investment

company the defendant is a depositor or underwriter; or

(b) purchasing, redeeming, or otherwise acquiring any security or interest in a security issued by the fund known as the Flexible Fund A Account of United Benefit Life Insurance Company, or any other similar investment company created under the laws of the United States or of a State, of which investment company the defendant is a depositor or underwriter; or

(c) selling or purchasing any securities or interests in securities, by whomsoever issued, for the account or on behalf of the fund known as the Flexible Fund A Account of United Benefit Life Insurance Company, or any other similar investment company created under the laws of the United States or of a State, of which investment company the defendant is a depositor or underwriter;

unless such investment company is registered as an investment company with the Securities and Exchange Commission in accordance with Section 8 of the Investment Company Act of 1940, as amended, 15 U.S.C. 80a–8.

3. Grant such other and further relief as the Court may deem meet.

Of Counsel:

/s/ SOLOMON FREEDMAN,
Associate Director.

/s/ ALAN R. GORDON,
Chief Counsel.

/s/ CHARLES T. GOOLSBEE,
Attorney.

Division of Corporate Regulation,
Securities and Exchange Commission,
Washington, D. C.

/s/ PETER A. DAMMANN,
General Counsel.

/s/ WALTER P. NORTH,
Associate General Counsel.

/s/ GEORGE P. MICHAELY, JR.,
Special Counsel.

/s/ ROBERT L. MCCLOSKEY,
Attorney.

Securities and Exchange Commission,
Washington, D. C.

Dated:

DISTRICT OF COLUMBIA,
City of Washington, ss:

Abraham A. Raizen, being first duly sworn, deposes and says:

I am employed by the Securities and Exchange Commission as Assistant Director of the Division of Corporate Regulation; my responsibilities relate to the administration of the Investment Company Act of 1940 and to the registration of companies thereunder. I have read the foregoing complaint and am familiar with the matters alleged and, upon information and belief, the facts set forth therein are true and correct.

/s/ ABRAHAM A. RAIZEN.

[Exhibits to complaint omitted.]

[Jurat omitted.]

[Filed November 13, 1962]

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

Civil Action No. 3096–62

SECURITIES AND EXCHANGE COMMISSION, 425 Second Street, N.W., Washington 25, D.C., PLAINTIFF,

v.

UNITED BENEFIT LIFE INSURANCE COMPANY, 3316 Farnam Street, Omaha 31, Nebraska, DEFENDANT

ANSWER TO COMPLAINT FOR INJUNCTION

First Defense

1. The Complaint and Counts One, Two, Three, Four, Five, Six and Seven thereof fail to state any claim upon which relief can be granted against defendant.

Second Defense

2. Defendant denies each and every allegation of the Complaint except insofar as any allegation of any paragraph or any subparagraph of the Complaint is admitted in paragraphs 3 through 18 of this Answer.

3. Defendant denies the allegations of paragraph 1, except that defendant admits that the present action is brought by plaintiff, the Securities and Exchange Commission, and admits and avers that defendant has written, is writing, and intends to write annuity policies which contain, among other things, provisions which constitute contractual guarantees on defendant's part in favor of holders of such annuity policies.

4. Defendant avers that the allegations of paragraph 2 are mere statements of conclusions of law and of plaintiff's opinion and not statements of fact, and need not be

answered by defendant; if answer be required defendant denies the said allegations.

5. Defendant denies the allegations of paragraph 3, except that defendant admits that plaintiff is seeking to invoke the jurisdiction of this Court, and is relying upon section 22(a) of the Securities Act of 1933, hereinafter referred to as "the 1933 Act", 15 U.S.C. section 77v.(a) and upon section 44 of the Investment Company Act of 1940, hereinafter referred to as "the 1940 Act", 15 U.S.C. section 80a–43.

6. Defendant denies the allegations of paragraph 4, except that defendant admits and avers that it is a corporation organized under the laws of the State of Nebraska, and that it is qualified to do business, has done business, and is doing business in the District of Columbia.

7. Defendant denies the allegations of paragraph 6, except that defendant admits that it now maintains and intends to maintain a separate account, known as the Flexible Fund A account, under the authority of the Nebraska statute which authorizes such separate accounts, Legislative Bill 301, Session Laws of Nebraska, 1961, chapter 217, effective March 22, 1961, sections 44–310.06 to 44–310.08 of *Reissue Revised Statutes of Nebraska, 1943, 1961 Cumulative Supplement*, hereinafter referred to as "R. S. Supp. 1961", in connection with the Annual Premium Flexible Fund Retirement Annuity policies, Form 560, Series 114L, which have been written by defendant since March, 1962, and in connection with said Annual Premium Flexible Fund Retirement Annuity policies which defendant intends to write in the future.

8. Defendant denies the allegations of paragraphs 10 and 33, except that defendant admits and avers that Exhibit A attached to the Complaint is a specimen copy of the Annual Premium Flexible Fund Retirement Annuity policy, one of the types of annual premium deferred annuity policies written by defendant, and admits and avers that Exhibit B attached to the Complaint is a folder prepared by defendant which contains a description of the said policy.

9. Defendant denies the allegations of paragraph 11, except that defendant admits and avers that documents in the form of Exhibits A and B have been published and disseminated by defendant.

10. Defendant denies the allegations of paragraph 12, except that defendant admits and avers, as follows:

(a) Exhibit A attached to the Complaint constitutes a specimen copy of the Annual Premium Flexible Fund Retirement Annuity policy written by defendant; the provisions of said annuity policy speak for themselves, and the legal effect of the contract will be decided by the Court; and the allegations of the subparagraphs of paragraph 12 which assert plaintiff's version of the legal effect of the said contract are mere statements of conclusions of law and of plaintiff's opinion and not statements of fact, and need not be answered by defendant.

(b) Exhibit B contains a description of the provisions of said Annual Premium Flexible Fund Retirement Annuity policy; said description is not relevant or material to a determination of the legal effect of the provisions of the Annual Premium Flexible Fund Retirement Annuity policy; and the allegations of subparagraphs of paragraph 12 which are predicated upon phrases from Exhibit B taken out of context are mere statements of conclusions of law and of plaintiff's opinion and not statements of fact, and need not be answered by defendant.

(c) Defendant admits that words which are quoted in subparagraphs (d), (e) and (k) of paragraph 12 appear, but in context, in Exhibits A or B attached to the Complaint.

(d) Defendant incorporates herein by reference the allegations of paragraphs 47 to 51 of this Answer, with like effect as if herein fully repeated.

11. Defendant denies the allegations of paragraph 14, except that defendant admits and avers that:

(a) Exhibit B contains charts which speak for themselves; and Exhibit B is not relevant or material to a determination of the legal effect of the provisions of the

Annual Premium Flexible Fund Retirement Annuity policy.

(b) The allegations of subparagraphs of paragraph 14 are mere statements of conclusions of law and of plaintiff's opinion and not statements of fact, and need not be answered by defendant.

(c) Defendant admits that the words quoted in subparagraphs (c), (d), (e), (h), (i), (j), (k), and (l) of paragraph 14 appear, but in context, in Exhibit B attached to the Complaint.

(d) Defendant incorporates herein by reference the allegations of paragraphs 47 to 51 of this Answer, with like effect as if fully repeated herein.

12. Defendant admits with respect to the allegations of paragraphs 15, 18 and 21 that the Annual Premium Flexible Fund Retirement Annuity policy issued by defendant is not registered as a security under the 1933 Act, as amended; but defendant avers that no registration under the said Act is required for the reason that said policy is not a security but an annuity contract, and defendant incorporates herein by reference the allegations of paragraphs 47 to 51 of this Answer, with like effect as if fully repeated herein.

13. Defendant admits and avers with respect to the allegations of paragraphs 35, 38 and 41 that provisions of the Annual Premium Flexible Fund Retirement Annuity policy which consist of guarantees of the cash value of the said policy, including the guarantee of the Minimum Cash Value of the said policy, are not registered as a security under the 1933 Act, as amended; but defendant avers that no registration under the said Act is required for the reason that neither the said policy nor any isolated provisions thereof are or can be a security; and defendant incorporates herein by reference the allegations of paragraphs 47 to 51 of this Answer and paragraph 59 of this Answer, with like effect as if fully repeated herein.

14. Defendant denies the allegations of paragraph 22, except that defendant admits and avers that the Flexible

Fund A account is maintained by defendant pursuant to sections 44–310.06 to 44–310.08 of R.S. Supp. 1961.

15. Defendant admits with respect to the allegations of paragraph 25 that the Flexible Fund A account, a separate account maintained by defendant under sections 44–310.06 to 44–310.08 of R. S. Supp. 1961, does not have a board of directors; but defendant avers that the said separate account is neither a corporation, nor a company, nor a separate entity; and defendant incorporates herein by reference the allegations of paragraphs 53 to 58 of this Answer, with like effect as if fully repeated herein.

16. Defendant admits with respect to the allegations of paragraph 29 that the Flexible Fund A account, a separate account maintained by defendant under sections 44–310.06 to 44–310.08 of R. S. Supp. 1961, is not registered as an investment company under the 1940 Act; but defendant avers that said separate account is neither an entity, nor a person, nor a company, nor an investment company, within the meaning of the 1940 Act; and in the event that said separate account were held to be an entity, or a person, or a company, or an investment company, said separate account would be exempt from registration under the 1940 Act; and defendant incorporates herein by reference the allegations of paragraphs 53 to 58 of this Answer, with like effect as if fully repeated herein.

17. Defendant denies the allegations of paragraph 31, except that defendant admits and avers, as follows:

(a) Exhibit B is not relevant or material to a determination of the legal effect of the provisions of the Annual Premium Flexible Fund Retirement Annuity policy written by defendant.

(b) The words quoted appear, but in context, in Exhibit B.

(c) Defendant guarantees the Minimum Cash Value of the Annual Premium Flexible Fund Retirement Annuity policy written by defendant, in the percentages of the gross premiums paid, as shown in paragraph 31, during the first 20 years during which the policy is in effect, and with the result that after the 17th year the guaranteed Minimum

Cash Value will exceed 90 percent of the total gross premiums paid.

18. Defendant denies the allegations of paragraph 34, except that defendant admits and avers, as follows:

(a) Exhibit B is not relevant or material to a determination of the legal effect of the provisions of the Annual Premium Flexible Fund Retirement Annuity policy.

(b) Exhibit B contains, but in context, the words quoted.

(c) The allegations of subparagraphs (a) and (b) of paragraph 34 constitute statements of conclusions of law and of plaintiff's opinion and not statements of fact, and need not be answered by defendant.

Third Defense

19. (a) In defendant's business generally and in defendant's business of writing the Annual Premium Flexible Fund Annuity policy defendant was and is engaged in business as an "insurance company" within the meaning of section 2(a)(17) of the 1940 Act, 15 U.S.C. section 80a–2(a)(17); and as an insurance company defendant is not and cannot be treated as an investment company, by virtue of section 3(c)(3) of the 1940 Act, 15 U.S.C. section 80a–3(c)(3).

(b) In defendant's business generally and in defendant's business of writing the Annual Premium Flexible Fund Retirement Annuity policy defendant was not and is not engaged in business as an "investment company" within the meaning of sections 3(a)(1), (2) or (3) of the 1940 Act, 15 U.S.C. sections 80a–3(a)(1), (2) or (3).

(c) In defendant's business generally and in defendant's business of writing the Annual Premium Flexible Fund Retirement Annuity policy defendant is not an "issuer" within the meaning of section 2(4) of the 1933 Act, 15 U.S.C. section 77b. (4); or within the meaning of section 2(a)(21) of the 1940 Act, 15 U.S.C. section 80a–2(a)(21); or within the meaning of section 3(a)(8) of the Securities and Exchange Act of 1934, hereinafter referred to as "the 1934 Act", 15 U.S.C. section 78c.(a)(8).

20. Defendant is a corporation organized and existing as an insurance company under the laws of the State of Nebraska, with its principal place of business in the City of Omaha, Douglas County, Nebraska. Defendant was organized in 1926, and at all times since then defendant has existed, and is presently existing, solely as an insurance company; at all times since 1926 defendant has engaged, and is presently engaged, solely in the business of insurance within the meaning of section 44–102 of *Reissue Revised Statutes of Nebraska, 1943,* hereinafter referred to as "R.S. 1943".

21. The nature of the business in which defendant has engaged, and is presently engaged, is described in Article II of defendant's Amended Articles of Incorporation, as follows:

> The nature of the business to be transacted, and the objects and purposes of the Company are to make Insurance upon the lives of individuals; and all and every Insurance pertaining thereto or connected therewith, including the granting, purchasing and disposing of Annuities and Endowments and including Double Indemnity and Disability Benefits; and if the Board of Directors shall deem it prudent at any time, to conduct also an Accident and Health Insurance Department.

22. Defendant is an insurance corporation which was formed for the purpose, in part, of writing life insurance including annuities; defendant was formed to write life insurance within the meaning of section 44–201(2) of R.S. 1943.

23. Defendant is presently registered to do business as an insurance company in each state of the United States, except for New York, and in the District of Columbia, Guam, Puerto Rico, the Canal Zone, the Virgin Islands, the Dominion of Canada and the Republic of Panama. As of June 30, 1962, defendant had assets in excess of $400,000,000 and capital and surplus in excess of $51,900,000,

and defendant has in force currently in excess of $2,800,000,000 worth of insurance.

24. Section 81–501 of R.S. 1943 (formerly section 44–104 of R.S. 1943) provides, in part, that the Department of Insurance shall have general supervision, control and regulation of insurance companies, associations and societies, and the business of insurance in Nebraska. Defendant has engaged in business and is presently engaged in business as an insurance company subject in all respects to the general supervision and control and regulation of the Department of Insurance of the State of Nebraska, and subject to the laws of Nebraska relating to insurance and to the Rules and Regulations of the Department of Insurance of the State of Nebraska.

25. Defendant has been and is subject to section 44–107 of R.S. 1943 which provides:

> The Department of Insurance shall cause each domestic company to be examined at least once every three years, and cause its affairs to be thoroughly inspected and examined to ascertain its true financial condition, its ability to meet and to fulfill its obligations, whether it has complied with the provisions of the law, and all other facts that may be required relating to its business, methods, and management, and its dealings with its policyholders. Whenever it deems it advisable, it shall cause a complete audit of the books and accounts of the company to be made by a disinterested expert accountant.

26. Defendant engages in the business of insurance subject to the supervision, control and regulation of the insurance department or insurance commissioner or director or similar agency or official of each of the states of the United States in which it is authorized to do business and of the District of Columbia.

27. In addition to the examination of defendant's affairs referred to in paragraph 25 hereof, defendant is subject to an examination of its affairs by the insurance department or insurance commissioner or director or similar

agency or official of each state in which it is authorized to do business and of the District of Columbia. This Triennial Convention Examination takes place, at least, every third year under the Rules and Regulatons of the National Association of Insurance Commissioners (N.A.I.C.). Copies of the report of the Triennial Convention Examination of defendant's affairs are filed with the appropriate agency or official of each of the said states and of the District of Columbia. In addition, defendant files each year an Annual Statement in the form prescribed by the National Association of Insurance Commissioners with the appropriate agency or official of each of the said states and of the District of Columbia.

28. Since 1926 defendant has written, and defendant is writing at present, and intends to write, only life insurance including annuities, and accident and sickness policies, in accordance with Nebraska law and with the laws of each of the other states of the United States in which it is authorized to do business and of the District of Columbia. The forms of the insurance policies which defendant has written and is writing and intends to write have been approved by the Department of Insurance of the State of Nebraska.

29. At present defendant writes two types of annual premium optional deferred annuity policies. Both types of policy contain the standard provisions required in annuity policies by the relevant provisions of Reissue Revised Statutes of Nebraska, 1943; and both types of policy have been approved by the Department of Insurance of the State of Nebraska as in conformity therewith. The one type of annual premium deferred optional annuity policy, which has been written by defendant for many years, is known as the Annual Premium Deferred Retirement Annuity policy. The other type of annual premium deferred optional annuity policy, which has been written by defendant since March 1962, is known as the Annual Premium Flexible Fund Retirement Annuity policy, a specimen copy of which is attached to the complaint as Exhibit A.

30. The two types of annual premium deferred optional

annuity policies referred to in paragraph 29 are both policies of life insurance within the conventional meaning of life insurance and within the meaning of Nebraska law. Each type of annuity constitutes a single integrated contract, which is acquired by a policyholder interested primarily in retirement annuity income in a fixed monthly dollar amount. Both types of policies are sold on a long-term basis, not less than ten years. Both types of annuity policies are issued by defendant, an insurance company, and contain those elements which are present in any conventional annual premium deferred optional annuity policy, including the following:

(a) Group sharing of longevity with a basic spread of risk between those who die early and those who die late, with use of reserves which are released by those who die early to sustain benefit payments to those who die late, with overall benefit payments to each annuitant significantly dependent upon his lifetime.

(b) A guarantee by defendant that no matter how long the policyholder (or the entire group of policyholders) lives, the fixed dollar amount of periodic monthly payments after maturity will not be thereby affected.

(c) Settlement options, exercisable by the annuitant, involving life contingencies on guaranteed mortality bases, and with guaranteed interest rates.

(d) Settlement options, exercisable by the beneficiary for no additional consideration, on guaranteed mortality bases and with guaranteed interest rates. Under (c) and (d) hereof defendant guarantees to the annuitant, or to the beneficiary, the rates at which income may be purchased at any time in the future for periods as distant as thirty years, despite the current trend toward significantly increased longevity of the population of the United States.

(e) Prior to the Maturity Date, a guaranteed Minimum Cash Value of the policy, obtainable by the annuitant upon surrender of the policy.

(f) Prior to the Maturity Date, a guaranteed death benefit payable to the beneficiary upon the annuitant's death.

(g) A guarantee of the expense margin on which the policy rates are predicated; so that defendant assumes the risk that defendant's expenses may exceed the said expense margin.

31. Both types of annuity policies written by defendant contain contractual provisions found in annuity policies generally, as follows:

(a) A grace period of thirty-one days is granted for the payment of every premium after the first premium, during which period the policy remains in force.

(b) At any time within three years after the due date of a premium in default the policy may be reinstated upon payment of arrears of premiums.

(c) If any premium remains unpaid at the end of the grace period, and the annuitant has not requested payment of the cash value, the then accumulated value is further accumulated until the Maturity Date, and then applied to purchase annuity income in accordance with the Table of Annuity Options for the option selected.

(d) No change or modification may be made except by agreement in writing.

(e) The policy is incontestable after it has been in force during the lifetime of the annuitant for two years from its date of issue, except for non-payment of premiums, and except as to provisions and conditions, if any, relating to benefits in the event of total and permanent disability.

(f) The right to change the beneficiary is reserved by the annuitant unless revocation of such right has been made in writing by the annuitant and acknowledged by the defendant. If the right to change has not been revoked, the annuitant may change any beneficiary designation by notice to the defendant.

(g) Assignment of the policy is binding upon defendant when the original or a duplicate of the assignment is filed with the defendant at its home office.

(h) A policy loan, or partial withdrawal of the cash value of the policy, may be made by the annuitant.

32. Section 44–310.06 to section 44–310.08 of R.S. Supp. 1961, provides, as follows:

> [Section 44–310.06] Any domestic life insurance company may, after adoption of resolution by its board of directors and certification thereof to the insurance commissioner, allocate to one or more separate accounts, pursuant to the provisions of applicable contracts, any amounts which are paid to such company in connection with a pension, retirement, or profit-sharing plan or annuity, and which are to be applied to purchase annuities or retirement benefits under such company's policies or contracts and to provide other benefits incidental thereto. The income, if any, and gains or losses, realized or unrealized, on each such account may be credited to or charged against the amount allocated to such account in accordance with such contract, without regard to the other income, gains, or losses of the company. The amounts allocated in such accounts and accumulations thereon may be invested and reinvested in any class of loans and investments authorized for domestic life insurance companies and such loans and investments shall not be included in applying the limitations provided in section 44–310.02. Amounts allocated by a life insurance company to separate accounts in the exercise of the power granted by sections 44–310.06 to 44–310.08 shall be owned by the company, and the company shall not be, or hold itself to be, a trustee in respect to such amounts. [Source: Laws 1961, c. 217, § 1, Effective date March 22, 1961.]
>
> [Section 44–310.07] Any domestic life insurance company which has separate accounts, to reserve, pension, retirement or profit-sharing plans or annuities, shall maintain a separate surplus account for the benefit of holders of such contracts from which it may, in the discretion of its board of directors, apportion dividends to the holders of such contracts. [Source: Laws 1961, c. 217, § 2, Effective date March 22, 1961.]

[Section 44–310.08] No investment in such separate account or in the domestic life insurance company's general investment account shall be transferred by sale, exchange, substitution or otherwise from one account to another. [Source: Laws 1961, c. 217 § 3, Effective date March 22, 1961.]

33. On December 26, 1961, the Board of Directors of defendant passed the following Resolution:

RESOLVED, That the officers be and are hereby authorized and directed to establish one or more segregated accounts, as permitted by LB 301 passed by the 1961 Nebraska Legislature, as they from time to time shall deem advisable;

BE IT FURTHER RESOLVED, That the proposed Flexible Fund Annuity, Form 560–Series 114L, is hereby authorized to be issued under said segregated account statute, and the officers be and they are hereby authorized and directed to file said Policy for approval in all jurisdictions in which the Company is licensed to do business;

BE IT FURTHER RESOLVED, That for the purposes of establishing said segregated account or accounts, the officers be and they are hereby authorized and directed to transfer to such account or accounts such amount of General Surplus as is deemed advisable;

BE IT FURTHUR RESOLVED, That the Investment Committee shall have all investment powers over the segregated account or accounts as they have been previously granted generally.

34. Defendant's Annual Premium Flexible Fund Retirement Annuity policy has been authorized for sale and issuance as an insurance policy by the insurance department or insurance commissioner or director or similar agency or official of the following states: Alabama, Alaska, Arizona, Arkansas, Colorado, Delaware, Georgia, Hawaii,

Massachusetts, Montana, Nebraska, Nevada, Oregon, Tennessee, Utah, Vermont and Virginia.

35. The Annual Premium Flexible Fund Retirement Annuity policy written by defendant is an annual premium optional deferred annuity. It differs from the other type of annual premium optional annuity written by defendant, the Annual Premium Deferred Retirement Annuity policy, only in the respect that under the Annual Premium Deferred Retirement Annuity policy defendant agrees to accumulate the amounts of the net premiums paid by the policyholder at the rate of 2½ percent, while under the Annual Premium Flexible Fund Retirement Annuity policy defendant agrees to accumulate the amounts of the net premiums in accordance with a formula described in the policy, which formula is predicated upon the income from and upon the market value of defendant's investments which are allocated to the separate account maintained under section 44–310.06 to section 44–310.08 of R.S. Supp. 1961.

36. Incidental to its business of insurance, defendant makes investments, in the manner and subject to the restrictions provided for by the relevant sections of R. S. 1943.

37. Section 44–310.06 of R. S. Supp. 1961, as quoted in paragraph 32 of this Answer, provides, in part, with regard to separate accounts that:

> • • • The amounts allocated in such accounts and accumulations thereon may be invested and reinvested in any class of loans and investments authorized for domestic life insurance companies and such loans and investments shall not be included in applying the limitations provided in section 44–310.02. • • •

38. Section 44–310.02 of R. S. 1943 provides that:

> No life insurance company shall be permitted to invest (1) more than ten per cent of its admitted assets in the securities described in subdivision 9 of section 44–309, or (2) a combined total amount of

more than ten percent of its admitted assets in the securities described in subdivisions (10) and (11) of section 44–309. The value of any such investment in securities described in subdivisions (9), (10), and (11) of section 44–309 for the purpose of applying the foregoing limits shall be the cost of any such investment to the life insurance company.

39. Section 44–309 of R. S. 1943 provides, in pertinent part:

> The capital, surplus, and other funds, or any part thereof, of every domestic life insurance company may be invested as provided in the following subdivisions (1) to (14), and sections 44–311.02 and 44–311.03:
>
> * * * * *
>
> (9) In the preferred stock of any corporation which has earned and paid regular dividends at the regular prescribed rate each year, upon its preferred stock for not less than five years next preceding the purchase of such preferred stock, or during such part of said five-year period as it shall have had preferred stock outstanding, and which corporation or its predecessor shall have earned each year during said five-year period dividends upon its stocks of at least one hundred thousand dollars;
>
> (10) In the common stocks of any corporation which shall have had earnings available for payment of dividends on its common stocks of not less than two hundred fifty thousand dollars per annum, for not less than seven years next preceding the purchase of such stocks, except that in cases of corporations having a majority of their operations in the State of Nebraska, the requirements as to the amount of earnings available for payment of dividends on its common stocks shall be twenty-five thousand dollars per annum;
>
> (11) In shares, interest or participation certificates in any management type of investment trust, corpo-

rate or otherwise; *Provided* that the assets of such investment trust shall be not less than ten million dollars at the date of purchase; *and provided further*, that not more than five per cent of the assets of any insurance company may be invested in such shares, interests, or participation certificates;

* * * * *

40. Defendant's investments which are allocated to the separate account under Nebraska law, Flexible Fund A account, are selected by the same group of persons who make investments generally for defendant, at the same time that other investments are selected for defendant, and in the same manner that other investments are made for defendant. The sole difference is that investments to be allocated to the said separate account, in conformity with Nebraska law, are not includable in applying the limitations provided in section 44–310.02 of R.S. 1943, quoted in paragraph 38 of this Answer. The investments, so allocated, which comprise common stocks, preferred stocks or shares in any management type of investment trust must conform to the criteria established by section 44–309 of R.S. 1943. All other types of investments allocated to the said separate account must conform to all the requirements of Nebraska law, both as to any quantitative, as well as to any qualitative, criteria which may be prescribed for such type of other investments.

41. The choice of the type and number of investments to be allocated to the Flexible Fund A account, made by the Investment Committee of defendant's Board of Directors, is controlled in large measure by the existence of the various contractual guarantees contained in the Annual Premium Flexible Fund Retirement Annuity policy, which are the same type of contractual guarantees offered by defendant in its Annual Premium Deferred Retirement Annuity policy.

Fourth Defense

42. In its business generally, and in its business of writing the Annual Premium Flexible Fund Retirement Annuity policy, defendant is not subject to registration under the 1940 Act, or subject to the control or supervision of the plaintiff, by virtue of the McCarran-Ferguson Insurance Regulation Act, 59 Stat. 33, 15 U.S.C. sections 1011-1015, which leaves regulation of the business of insurance entirely to the states, and denies the power of such regulation to the federal government, including the plaintiff.

43. The provisions of the McCarran-Ferguson Insurance Regulation Act make reference solely to the Sherman Act, the Clayton Act, the Federal Trade Commission Act, the Robinson-Patman Anti-discrimination Act, the National Labor Relations Act, the Fair Labor Standards Act, and the Merchant Marine Act, 1920, and do not refer to the 1933 Act or to the 1940 Act. Neither the 1933 Act nor the 1940 Act relates to the business of insurance.

44. Defendant is engaged solely in the business of insurance under and subject to the laws of the State of Nebraska and of the other states in which defendant is authorized to do business and of the District of Columbia. The laws of Nebraska, including sections 44-101 et seq. of R. S. 1943, provide for the regulation and taxation of defendant's business. By virtue of the McCarran-Ferguson Insurance Regulation Act, therefore, defendant's said business is not amenable to or subject to the provisions of the 1933 Act or of the 1940 Act.

45. Application of the 1933 Act or of the 1940 Act to defendant's business generally or to defendant's business of writing the Annual Premium Flexible Fund Retirement Annuity policy would create a direct conflict between the said federal laws and the laws of Nebraska, and such application would contravene directly the McCarran-Ferguson Insurance Regulation Act, which prohibits any act which would invalidate, impair or supersede the applicable laws of Nebraska which regulate and tax defendant's business.

46. Application of the said federal laws to defendant's said business, in contravention of the McCarran-Ferguson Insurance Regulation Act, would result in treating defendant's business as other than the business of insurance, with the further result that the Nebraska laws under which defendant is incorporated, organized, operated and regulated, and pursuant to which its policies are approved and written, and which regulate and tax defendant's business, would be invalidated, impaired and superseded.

Fifth Defense

47. The Annual Premium Flexible Fund Retirement Annuity policy written by defendant is an annuity, and it is not a "security" within the meaning of section 2(1) of the 1933 Act, 15 U.S.C. section 77b.(1), or within the meaning of section 3(a)(10) of the 1934 Act, 15 U.S.C. 78c.(a)(10), or within the meaning of section 2(a)(35) of the 1940 Act, 15 U.S.C. section 80a-2(a)(35); the said annuity policy written by defendant is specifically exempt from the provisions of the 1933 Act, by virtue of the provisions of section 3(a)(8) of the 1933 Act, 15 U.S.C. section 77c.(a)(8), since said annuity policy is an insurance policy, an annuity contract, and an optional annuity contract, issued by defendant insurance company, which is a corporation subject to the supervision of the Department of Insurance of the State of Nebraska, and defendant incorporates by reference the allegations of paragraphs 30 and 31 of this Answer, with like effect as if herein fully repeated.

48. Exhibit A attached to the Complaint is a specimen copy of defendant's Annual Premium Flexible Fund Retirement Annuity policy. Making the following assumptions: Annuity Income—$6.30; Age at Issue—35; Date of Issue—April 1, 1962; Premium—$100.00 monthly; Age at Maturity—65; Annuity Option—A; said Exhibit A would give the holder thereof, hereafter referred to in this paragraph as "the Annuitant," the following rights and would subject the defendant to the following obligations:

(a) The Annuitant will pay a $100 monthly premium from the date of issue (April 1, 1962) until the Maturity Date 30 years hence (April 1, 1992). On the Maturity Date and each month thereafter, defendant will pay a guaranteed fixed dollar monthly annuity income of $6.30 per $1000 cash value, in accordance with Option A of Table 1.

(b) Said monthly amount of $6.30 per $1000 cash value is guaranteed by defendant, without relation to actual expenses incurred by defendant, and without relation to actual mortality experience, even though that experience may be more adverse to defendant than expected. Defendant agrees to pay to the Annuitant, beginning on Maturity Date, a monthly annuity income in such amount as the then cash value of the policy, as provided in Section 9, will purchase in accordance with Table 1. Table 1 of Exhibit A is the same table utilized by defendant in the Annual Premium Deferred Retirement Annuity policy issued by it.

(c) All amounts of net premiums paid on the policy by the Annuitant to defendant are credited to the Flexible Fund A account, a separate account maintained by defendant in accordance with sections 44–310.06 to 44–310.08 of R. S. Supp. 1961. Net premiums are the following portions of each premium paid by the Annuitant for the respective policy years: first year—50.0 per cent; second to tenth year—90.5 per cent; eleventh year and thereafter—95.0 per cent.

(d) The accumulated value of the policy at the end of any month is the accumulated value as of the end of the previous month, increased by net premiums and multiplied by the Monthly Accumulation Rate as defined in Section 12 of the policy. The Flexible Fund A account constitutes an internal accounting mechanism utilized by defendant for the determination of the said Monthly Accumulation Rate.

(e) At any time prior to the Maturity Date, the policy may be surrendered and defendant will pay the cash value thereof to the Annuitant. The cash value is (1) the amount of accumulated value as computed on the basis of net

premiums and the Monthly Accumulation Rate, or (2) the guaranteed Minimum Cash Value—whichever is higher. The guaranteed Minimum Cash Value is determined by applying a specified per cent figure to the sum of the net premiums which have been paid, as follows:

Years for Which Premiums Paid	Per cent
1	50
2	55
3	60
4	65
5	70
6	75
7	80
8	85
9	90
10 or more	100

After ten years, therefore, the guaranteed Minimum Cash Value equals 100 per cent of the sum of the net premiums which have been paid by the Annuitant to defendant.

(f) If the Annuitant dies before the Maturity Date defendant will pay to the beneficiary, either (1) the amount equal to the cash value of the policy, or (2) the sum of the gross premiums which have been paid—whichever is higher.

49. The guaranteed Minimum Cash Value of the Annual Premium Flexible Fund Retirement Annuity policy, in comparison with the guaranteed cash value of the Annual Premium Deferred Retirement Annuity policy for selected years, assuming, each instance, a $100 monthly premium, is, as follows:

Years Premiums Paid	Annual Premium Flexible Fund Retirement Annuity	Annual Premium Deferred Retirement Annuity
5	$ 3,460.80	$ 5,203.82
10	10,374.00	11,561.48
15	16,074.00	18,749.90
20	21,774.00	26,896.01

50. Defendant's Annual Premium Flexible Fund Retirement Annuity policy provides, among other things, that prior to the Maturity Date the aggregate reserve for the

policy shall be the cash value, increased by such contingency reserve as may be necessary to cover the minimum death benefit guarantee; and provides that after the Maturity Date the reserve shall be based on the 1937 Standard Annuity Table of Mortality, rated down one year for males and six years for females, with interest at two and one-half per cent. Defendant has established, and will maintain, true insurance reserves in connection with Annual Premium Flexible Fund Retirement Annuity policies issued by defendant.

51. Defendant's insurance reserves which are and will be maintained in connection with defendant's Annual Premium Flexible Fund Retirement Annuity policies will be under the direct approval and supervision of the Department of Insurance of the State of Nebraska, and will have to be sufficient to cover defendant's liabilities, in accordance with the contractual guarantees offered by defendant in the said policies, as follows:

(a) The amount of the Minimum Cash Value guaranteed, in excess of the cash value as determined by the accumulation of amounts of net premiums at the Monthly Accumulation Rate as defined in the policy;

(b) The cash value as determined by the accumulation of amounts of net premiums at the Monthly Accumulation Rate as defined in the policy; and

(c) The death benefit guaranteed, consisting of the total of the amounts of gross premiums paid, in excess of the cash value.

52. Because of the guarantees referred to in paragraph 51 of this Answer defendant and its stockholders assume the risk of any decline in the value of defendant's investments allocated to the Flexible Fund A account prior to the Maturity Date of the policy. If the value of defendant's said investments declined to zero, so that the cash value (as defined in subparagraph (b) of paragraph 51 of this Answer) would amount to zero, the annuitant would, nevertheless, have the right to obtain the full amount of the Minimum Cash Value guaranteed. Further, if the value

of defendant's said investments allocated to the Flexible Fund A account should decline to zero, so that the cash value (as defined in subparagraph (b) of paragraph 51 of this Answer) would amount to zero, and the annuitant should die, prior to the Maturity Date, the annuitant's beneficiary would, nevertheless, have the right to obtain the full amount of the death benefit guaranteed which consists of the total amount of gross premiums paid.

Sixth Defense

53.(a) The Flexible Fund A account is not an entity, legal or otherwise, and the said separate account is merely the designation of an internal accounting mechanism utilized by defendant in computing the Monthly Accumulation Rate as defined in the Annual Premium Flexible Fund Retirement Annuity policy, and the said Flexible Fund A account has no existence otherwise.

(b) Said separate account is neither a "person" within the meaning of section 2(a)(27) of the 1940 Act, U.S.C. section 80a–2(a)(27); nor a "company" within the meaning of section 2(a)(8) of the 1940 Act, 15 U.S.C. section 80a–2(a)(8).

(c) Said separate account is not an "issuer" within the meaning of section 2(4) of the 1933 Act, 15 U.S.C. section 77b.(4); or within the meaning of section 2(a)(21) of the 1940 Act, 15 U.S.C. section 80a–2a(21); or within the meaning of section 3(a)(8) of the Securities and Exchange Act of 1934, 15 U.S.C. section 78c.(a)(8). Purchasers of defendant's Annual Premium Flexible Fund Retirement Annuity policy enter into contracts with defendant; they could not, and do not, enter into contracts with the said separate account.

(d) Said separate account is not an "investment company" within the meaning of either section 3(a)(1) or section 3(a)(2) or section 3(a)(3) of the 1940 Act, 15 U.S.C. section 80a–3(a)(1)(2)(3). Even if said separate account were deemed to be an issuer or to be a company, the said separate account would be exempt from regis-

tration under section 3(c)(3) of the 1940 Act, 15 U.S.C. section 80a–3(c)(3), as an "insurance company."

54. Under section 44–310.06 of R. S. Supp. 1961, by virtue of which amounts are allocated by defendant to the said separate account, said amounts are owned by defendant, and defendant cannot be, nor lawfully hold itself out to be, a trustee in respect to such amounts. The holder of defendant's Annual Premium Flexible Fund Retirement Annuity policy, or his designated beneficiary therein, has no interest, direct or indirect, in any of defendant's investments, including defendant's investments which are allocated to the said separate account, Flexible Fund A account. Said holder has only contractual rights against defendant as defined in the said policy.

55. Defendant has established, and will establish, policy reserve liabilities in connection with the Annual Premium Flexible Fund Retirement Annuity policies which have been written and will be written by defendant; the amounts allocated by defendant to the Flexible Fund A account constitute a part of such policy reserve liabilities. These reserves, as well as all of defendant's reserves, are subject to the control of defendant's Board of Directors, and to the supervision, audit, examination, and control of the Department of Insurance of the State of Nebraska.

56. The contractual relationship between defendant and the purchaser of any Annual Premium Flexible Fund Retirement Annuity policy written by defendant is solely that of creditor and debtor, in which the purchaser is the creditor and defendant the debtor. By the contract known as the Annual Premium Flexible Fund Retirement Annuity policy defendant obligates itself, on and after the Maturity Date, to make fixed dollar monthly payments in guaranteed amounts for the life of the annuitant in accordance with the option selected. Prior to the Maturity Date the holder of the Annual Premium Flexible Fund Retirement Annuity policy is guaranteed a cash value of the policy. Defendant's policy reserves maintained in connection with the said

Annual Premium Flexible Fund Retirement Annuity policies represent liabilities of defendant.

57. None of defendant's assets are earmarked for, nor do they otherwise constitute assets allocated to, any reserve accounts. The holders of defendant's Annual Premium Flexible Fund Retirement Annuity policies are solely creditors of defendant and, as such creditors, they have the right to look to the totality of defendant's assets to meet the liabilities to them which have been assumed by defendant in the annuity contracts held by such policyholders.

58. Defendant's aggregate reserves, which are subject to the supervision and control of the Department of Insurance of the State of Nebraska, are an actuarial determination, made in accordance with applicable Nebraska law, of the anticipated obligations of defendant to its policyholders. Defendant's reserves, including the reserves maintained and to be maintained in connection with defendant's Annual Premium Flexible Fund Retirement Annuity policies, are the conventional reserves of an insurance company, and are computed by conventional actuarial methods, and are maintained under the direct supervision and control of the Department of Insurance of the State of Nebraska.

Seventh Defense

59. The contractual provisions of defendant's Annual Premium Flexible Fund Retirement Annuity policy which refer to the Minimum Cash Value guaranteed by defendant are not a "security" within the meaning of section 2(1) of the 1933 Act, 15 U.S.C. section 77b.(1), or within the meaning of section 3(a)(10) of the 1934 Act, 15 U.S.C. section 78c.(a)(10), or within the meaning of section 2(a)(35) of the 1940 Act, 15 U.S.C. section 80a–2(a)(35). Said contractual provisions are but a part of a single integrated contract, and, as such, could not be separately considered a security.

Eighth Defense

60. (a) The holder of defendant's Annual Premium Flexible Fund Retirement Annuity policy is entitled, after the Maturity Date, to a fixed dollar monthly income in a guaranteed amount. The holder has the opportunity, at the Maturity Date, of acquiring a fixed dollar monthly income in an amount even higher than that guaranteed, if the accumulated cash value of the policy on the Maturity Date determined in accordance with the Monthly Accumulation Rate will provide an amount of monthly income higher than that guaranteed.

(b) At all times prior to the Maturity Date defendant bears the risk of loss in connection with the value of the investments allocated to Flexible Fund A account.

(c) Defendant's solvency and its capability of meeting its contractual obligations with regard to the Annual Premium Flexible Fund Retirement Annuity policy, and with regard to its business generally, is ensured by the supervision of the Department of Insurance of the State of Nebraska, and by the investigation of defendant's business made under the Rules and Regulations of the National Association of Insurance Commissioners.

WHEREFORE, defendant demands a final judgment in its favor, dismissing the Complaint and each count thereof, and denying the injunctive relief prayed for in the Complaint.

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By: /s/ M. JOSEPH STOUTENBURGH,
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EDWIN P. ROME,
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MORRIS L. WEISBERG

Dated: November 13, 1962.

TRANSCRIPT OF PROCEEDINGS BEFORE JUDGE CURRAN *

(March 15, 16 and 22, 1965)

* * * * *

[1] APPEARANCES:

WALTER P. NORTH, ESQ., ALAN GORDON, ESQ., ROBERT L. MCCLOSKEY, ESQ., for the Plaintiff.

M. JOSEPH STOUTENBURGH, ESQ., DANIEL J. MCCAULEY, JR., ESQ., MORRIS L. WEISBERG, ESQ., DONALD F. EVANS, ESQ., for the Defendant.

* * * * *

[5] OPENING STATEMENT BY COUNSEL FOR THE PLAINTIFF

Mr. NORTH: May it please the Court, since we have no jury involved in this case and the Court has already been subjected to lengthy pretrial statements and trial briefs, I assume that I may keep my opening statement to a minimum. * * *

* * * * *

[6] Briefly, we expect to demonstrate that the defendant has made use of the mails and other inter-state facilities sufficient to create federal jurisdiction and to invoke the Federal Securities laws, particularly the Securities Act of 1933 and the Investment Company Act of 1940.

They have done this incident to offering, selling, and delivering after sale, a certain form of contract, which will be introduced in evidence, which we expect to establish before the Court are investment contracts and, as such, are securities under the Securities Act of 1933, and that the defendant proposes to continue to sell these contracts by the use of interstate facilities, if not enjoined in the manner prayed for in the complaint.

Next, we expect to prove that, as shown by the contracts

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* Corrected in accordance with stipulation filed May 10, 1965.

themselves and related documents which constitute a part of the contractual arrangement, that the purchasers of this contract are, in fact, investors in a pool of securities, a portfolio of investments, largely equity [7] securities, which pool of securities is sponsored and managed by the defendant, United Benefit Life Insurance Company, it being the expectation of the purchasers of these securities to profit by the trend in the securities markets and the skill of the defendants in buying and selling in and out of those markets, and otherwise managing the fund in their behalf.

Thus, we expect our proof will demonstrate that the defendant has, in fact, created and is now sponsoring and managing an investment fund which is designated as "Flexible Fund Account," or "Flexible Fund A,"—it has various designations—which is a separate and segregated unit apart from all other insurance and annuity operations carried on in the United Benefit, and that that fund in and of itself is an investment company within the meaning of the 1940 Act and is, therefore, subject to registration under that Act, and to the various regulatory provisions set forth in it, but that the defendant has not, in fact, registered under either that Act or the 1933 Act which was mentioned earlier.

Admittedly, these contracts will show, when they are in evidence before the Court, that they have some features which are not strictly and entirely typical securities features, [8] but in that respect they are not materially different from what was before the Supreme Court in the VALIC case and in the Third Circuit in the Prudential case where, again, you were dealing in contracts that had non-securities features to some extent.

As we see it, and we believe this is what the proof will demonstrate, there is only one respect in which this contract differs in any sense that could even approach a material respect from the ones already passed upon in other litigation, and that is what they designate the "guaranteed minimum cash value."

In other words, as we see it, this law suit really centers

around the fact (sic: question) of whether or not that feature is of sufficient significance to lead the Court to reach a different result than has been reached in other cases before, and we expect in that regard to show that this feature is a more or less minimal feature, and it certainly is not the principal consideration which a purchaser seeks to acquire when he buys one of these contracts, its major aspects being of a securities nature and subject to the securities laws which I earlier mentioned.

The COURT: Is the cash value fixed at the time of the purchase of the policy?

[9] Mr. NORTH: No.

Now, are you talking about the—this guaranteed minimum cash value?

The COURT: Yes.

Mr. NORTH: That is dependent upon a sliding scale which, in turn, depends on the number of years the contract has been in effect.

A certain percent of the net payment in each year is guaranteed, but it is on a sliding scale, so you can't determine in advance unless you know what date on which—unless you know the date on which it is to be surrendered for its cash value.

The COURT: You mean if I purchase the policy I don't know what the cash surrender value will be in any given year?

Mr. NORTH: No. I am sorry if I gave that impression. Depending on the year in which you surrender it the cash value can then and there be fixed to the exact dollar by reference to the percentages that are specified in the contract, yes.

The COURT: Now, when is the amount fixed in dollars that I would receive for the rest of my life? Is that fixed at a future date, depending upon the condition of the [10] flexible fund?

Mr. NORTH: That is not fixed until you reach the maturity date, whatever date you, as a contract purchaser, selected on which to retire.

The COURT: How is the amount agreed upon? Does it

depend upon whether the flexible fund has made money or lost money?

Mr. NORTH: It depends on whether the fund has lost money or made money between the time you buy the contract originally and the time you convert it into an annuity at maturity date, subject only to the minimum limitation that no matter what the experience may have been on the securities market as to this particular fund, it can't drop below the so-called guaranteed minimum cash value. That is a floor. Other than that floor, the thing fluctuates the amount you will get——

The COURT: There was no floor in VALIC, was there?

Mr. NORTH: There was no floor in VALIC; that's right.

The COURT: So that the policy holder in this case is guaranteed that he will get back at least what he put in; right?

Mr. NORTH: No, no. The minimum guarantee doesn't [11] approach what he put in.

Now, if the policy runs enough years—the contract runs enough years so that the later years when the guarantee is relatively higher will offset the earlier years when it is low, it will gradually approach something like 90 percent of what you put in, but it never reaches all that you put in, and in the earlier years it is much less than that. Plus the fact, of course, that everything that has been earned on your share in the fund in the meantime is lost, and they bear no part of that risk. The most they are bearing is a proportional share of the risk of the loss of the amount of the initial investment on a net basis. Even then you don't get back whatever is deducted for sales charges, or expenses, or anything of that sort.

The COURT: Suppose I pay a hundred dollars a month for thirty years. At the end of thirty years I want to cash it in; what do I get back? Thirty-six thousand dollars?

Mr. NORTH: No, no. You would get back basically what was represented by the investment experience of your thirty-six thousand dollars minus the sales load that is taken off at the beginning, and minus a monthly charge

taken off every month during the thirty years, but subject to——

The COURT: There is nothing wrong with that, is there?

[12] Mr. NORTH: What?

The COURT: There is nothing wrong with that, is there?

Mr. NORTH: No, no. There is nothing wrong with it.

The COURT: Now, when the maturity date is reached do I understand that the policy holder then decides whether or not he is going to leave it alone and take his annuity, so-called, for the rest of his life in monthly payments?

Mr. NORTH: He makes that decision at maturity date to either purchase an annuity, or take back all of his share in the fund in cash.

The COURT: Suppose he decides to purchase the so-called annuity? How is the monthly amount reached? Does it depend upon the financial condition of the flexible fund?

Mr. NORTH: It depends entirely upon the condition of the flexible fund on the date the maturity date is reached except for this guaranteed minimum.

The COURT: As I understand, the amount the annuitant is to receive in monthly payments for the rest of his life depends upon the financial condition of the flexible fund. In other words, if they have made money, he will get a bigger annuity, and if they lost money he will get a smaller annuity.

Mr. NORTH: That's right.

[13] The COURT: Now, how low can that monthly amount go to. Is there a guarantee on that, or can he wind up with nothing?

Mr. NORTH: No, no. He can't wind up with nothing. There is a guarantee that his share in the fund will equal a certain minimum which, in turn, is bound to purchase a certain amount of annuity based on the annuity tables.

The COURT: That is not VALIC, is it?

Mr. NORTH: It is not VALIC in the sense that it could drop to zero.

The COURT: VALIC could.

Mr. NORTH: That's right.

And as I stated in my opening statement, that is the one thing that we think has to be decided in this case, really, whether this minimum guarantee is of sufficient significance to break this case away from the VALIC doctrine. We think that is the issue in this case.

The COURT: I think so.

Mr. NORTH: And you raise the question, Your Honor, about the payout period.

I am glad to state right at the beginning of the case that since the dollar amount of the annuity does become fixed at maturity date, if he elects to take an annuity, we [14] are not claiming the federal securities laws have any application to the bona fide fixed-dollar annuity policy which he receives on that date and has for the rest of his life.

We are saying that it is during the payin period that the contract holder is engaged in investing his money through the medium of a pool managed by Prudential (sic: United Benefit). And it is at that stage that the federal securities laws are applicable.

That is another difference, perhaps, because, as I remember it, both in VALIC and in Prudential, even after the maturity date the amount of money the annuitants received in any one month for the rest of his life still continued to fluctuate with the market experience of the fund in which he had bought interest.

The COURT: But once the amount is fixed at maturity date, even if the flexible fund went bankrupt, the insurance company would still have to pay the annuitant a certain amount of money until he died.

Mr. NORTH: That annuitant has absolutely no interest in the flexible fund once he has received his true annuity, and then he is no longer in the flexible fund at all.

[15] The COURT: You say the amount that he is to receive, if he buys the alleged annuity, that amount depends upon the financial position of the flexible fund; right?

Mr. NORTH: Depends entirely on that, subject only to this minimum below which it cannot go no matter how

poorly the market performs in the meantime; yes, sir, that is correct.

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OPENING STATEMENT BY COUNSEL FOR THE DEFENDANT

Mr. McCAULEY:

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[19] . . . And our position is that this is nothing more than a product developed by a company looking toward the VALIC case, trying to comply with what the Supreme Court said in the VALIC case, and at the same time doing nothing more than extending the opportunities of [20] its policy holders to participate in the investment experience of the company with respect to these particular net premiums, and that this so-called "shot at the alley" (sic) doesn't derogate from the basic undertaking of the company to pay from the beginning guaranteed fixed dollars, just exactly and precisely the type of investment risk that Mr. Justice Douglas said did not occur and did not take place and was not a part of the VALIC situation—all of those things are here. He doesn't equate, he doesn't announce, and there is nothing in the opinion that indicates that you have to take the quality of the investment risk and measure it, or the quantity of the investment risk and measure it.

He says if a company takes some investment risk, that is insurance. We take that risk, and that is the defendant's position.

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[25] The Deputy CLERK: Plaintiff's Exhibit Number 7 for identification.

(Plaintiff's Exhibit Number 7 was marked for identification. Specimen policy of the deferred retirement annuity.)

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[26] Mr. McCauley: I point out to the Court that this policy, which is Plaintiff's Exhibit Number 7, is the deferred retirement annuity today being issued by this company, and is a 1964 series. We will be offering examples of the deferred annuity issued at the time the law suit was instituted.

Mr. North: Your Honor, we have quite a few other exhibits, and some questions and answers that we want to offer in evidence a little later, but I think we have already offered [27] all that is basically required to precede the testimony of our principal expert witness who is here under rather adverse circumstances from the standpoint of health, and I would like to call him at this time even though it may be a little out of order, and I would like to have the examination conducted by Mr. Alan Gordon to whom I referred earlier.

Mr. McCauley: Is Professor Patterson in the room?

Mr. North: Yes.

Mr. McCauley: I would ask that we either have a conference at sidebar or that we ask Professor Patterson to leave the room. I would like to have an offer of proof, and I would like to see what the offer of proof is and, perhaps, make argument with respect to his testimony.

The Court: Very well. He may be excused.

(Witness excused from the courtroom.)

Mr. McCauley: I have noticed that Professor Patterson is not in the courtroom, and the defendant requests that the plaintiff submit an offer of proof with respect to the testimony to be adduced from or through this witness.

The Court: Very well.

Mr. Gordon: May it please the Court, the plaintiff intends to show through the testimony of Professor Patterson, first, that he is an established authority in the fields of [28] insurance concepts, practices, understandings and usage of the trade in industry, understanding technical terms used in the trade in industry. And then we expect

to show substantively that it is his opinion that the arrangements which are spelled out in the defendant's documents styled the flexible fund retirement annuity would not be generally recognized or regarded in the insurance trade as an annuity contract as that term and that concept has been traditionally understood and used in the industry.

He will also testify with respect to the extent to which there are elements of insurance in the totality of the arrangements and to the extent to which elements of the arrangements are not properly understood, as accepted in the trade of insurance, as insurance elements.

And then, finally, he will offer an opinion in regard to the character of the entirety of the arrangement as to whether in the understanding and usage of the insurance business this would be recognized as an annuity contract or deferred annuity contract or participating deferred annuity contract.

It is for that purpose we offer his testimony, sir.

Mr. McCauley: It is the position of the defendant, Your Honor, that the opinions of Professor Patterson, or anyone [29] else, with respect to what has traditionally been understood to be insurance or annuities is entirely immaterial and irrelevant to the determination of the issues in this case.

Mr. Justice Douglas said that there was no intention—and I am paraphrasing—to freeze the concept of annuities as of the time of the enactment of the 1933 Act, and in the dissenting opinion Mr. Justice Harlan said the same thing.

If there was anything, and I suppose the only thing, that the nine Justices who heard that case agreed on, was that you couldn't freeze the concept of annuity to a particular period of time, to wit, the date of the enactment of this statute.

This Commission is now back here, in 1965, after having tried that case, I believe, in 1957, trying to establish the same things through this witness that that Court, the

Supreme Court, decided were not, as a matter of law, to be considered controlling on that Court.

Consequently, we think that any testimony dealing with what traditionally may be conceived to be insurance or an annuity is absolutely irrelevant and immaterial under the tests laid down in the VALIC case.

It is that case, and the opinion in that case, which sets forth the guidelines.

Secondly, any opinion to be given by this witness on [30] the character of the arrangement usurps the function of the Court. It is absolutely improper. Consequently, we do not think on the basis of the offer of proof that has been submitted that the testimony, as they indicate it will be adduced, is relevant and material and necessary to a determination of the issues in this case by Your Honor.

Judge Wilkins, who sat in—I don't know if it was the same chair, but figuratively the same chair—listened for two weeks to experts on both sides, and wrapped it all up in his opinion by saying it was all very interesting, but—and then he went to the four corners of the document, and he went to his general experience, and he made a determination, and throughout that case in the Court of Appeals and, again, in the Supreme Court, I don't think there is a scintilla of a sentence that refers to any of the testimony of all of these so-called experts.

The test in the matter before you with respect to the testimony of this witness is that it is irrelevant what traditionally was or was not, in his opinion, insurance or annuity. These concepts are not frozen, they are not fixed.

Mr. GORDON: May it please the Court, it seems to us that the defendant is seeking to again argue to Your Honor the very issue that was raised by the defendant in their motion for [30-a] summary judgment when they took the position that there were no matters of fact requiring a trial, and it was the plaintiff's view that there were facts in dispute—these very facts. And, of course, the motion was denied, and, basically, for the same reasons and on

the basis of the same arguments which we made in that context we seek to have Professor Patterson's testimony adduced today.

The COURT: Objection is sustained. You can prove your case without the opinion of an expert. I will decide what it is.

* * * * *

[31] Mr. NORTH: May it please the Court, I appreciate the Court's offering to give us a brief recess, because the ruling did come as somewhat of a surprise to us. A great deal of work and effort has gone into the preparation of Professor Patterson to testify.

The conclusion we come up with, if the Court will permit us to do so, is that, in view of the advanced age and precarious condition of Professor Patterson's health, and the possibility of course, that this case might have to be retried, though we all hope it will not—we would like to at least preserve his testimony in the form of a special record. It will not be a lengthy one. As a matter of fact, we have exactly twenty questions, and twenty answers of no great length, and we would like to make a record of them.

In the meantime, I would like to hand up the original of the letter from the Professor's doctor, which shows the state of his health. A copy of this was brought here—

The COURT: I do not doubt that his health is bad. Do you want me to see the twenty questions?

Mr. MCCAULEY: I would like to state an objection to it. We endeavored to take Professor Patterson's testimony at a time when, so far as we knew, he was in good health, and they objected to it vigorously, and we were turned down [32] by Judge Youngdahl, and I object to any effort on their part now at this stage of the trial to, in these proceedings, try to put in this record or to preserve any testimony with respect to this witness. They are hoist on their petard on their objection to my taking his deposition when I wanted to.

Mr. NORTH: Your Honor, I think it is well established,

and that is the basis on which Judge Youngdahl ruled, that neither side is entitled to examine for purposes of discovery expert witnesses on the other side of a case.

That is why we objected at that time, and, of course, none of us foresaw what has happened since. And I do not think that the fact that we did not want them in advance of trial to be able to brain pick our expert witness, should have anything to do with whether we are entitled to make a special record of his testimony here in Court today.

The COURT: I will sustain the objection.

Mr. NORTH: I would still like to hand up the letter that was addressed to the Court on this subject.

The COURT: You mean about his physical condition?

Mr. NORTH: Right.

(Handed.)

By mistake, we brought your Honor down a carbon [33] copy of that a few days ago, whereas the original should have been brought to you. It is really your letter, not ours.

The COURT: It may be filed.

Mr. NORTH: Thank you.

Deputy CLERK: Plaintiff's No. 8–A, 8–B and 8–C for identification, comprising annual statements.

(Annual statments marked for identification Plaintiff exhibits 8–A, B and C.)

Mr. NORTH: Your Honor, I identify exhibits 8–A, B and C as being respectively the annual statement as to United Benefit Life Insurance Co., addressed to the Insurance Department of the State of Nebraska, in relation to United Benefit operations generally for the year 1963; the annual statement—I am talking now about "B," instead of "A"—of the separate account business, which is this special flexible annuity fund; and 8–C, the schedules of the various investments which are reflected in the annual reports, all to the State of Nebraska.

Mr. MCCAULEY: I have no objection. I just wanted to

point out that these go to every state in which the company does business, and the document that is going into evidence is not specifically addressed to the State of Nebraska, although a copy went there.

The COURT: It may be admitted.

* * * * * *

[39] Mr. NORTH: Next, your Honor, under the doctrine that long-standing administrative practice of an agency that administers a federal statute, is entitled to considerable weight as to the true nature of what it does in respect to matters within its jurisdiction, I would like to offer four very early registration statements under the 1940 Act, by funds which were very comparable, we say, to this unincorporated pool of securities that we are dealing with in the present case.

[40] These are merely instances of administrative practice from the early days of the adoption of the act.

Deputy CLERK: Plaintiff's exhibit 12-A, 12-B, 12-C and 12-D for identification.

(Plaintiff's Exhibits 12-A, 12-B, 12-C and 12-D, marked for identification.)

Mr. NORTH: In each instance, your Honor, the documents which we have had certified by the secretary of the Commission consists of the notification of registration filed by the fund, complete, including all information submitted to describe the nature of the fund which is there-by being offered for registration.

The COURT: Filed by whom?

Mr. NORTH: The first one, 12-A, is the registration of the Alexander Fund.

The COURT: The what?

I did not hear what you said, the what?

Mr. NORTH: The Alexander Fund, is the name of it.

The COURT: Filed by defendant corporation?

Mr. NORTH: No, no.

The COURT: Filed by whom?

Mr. NORTH: Filed by the applicant for registration. Filed by the Alexander Fund in this case.

The COURT: What has that got to do with this case?

[41] Mr. NORTH: It is offered solely to show, your Honor, a longstanding practice of accepting for registration under the 1940 Act pools of—liquid pools of securities which are organized on a basis other than an incorporation or a separate legal entity in the ordinary sense of the word, which is the very contention we are up against here, that this flexible fund is not subject to registration under the 1940 Act because it is merely a part of United Benefit Corporation.

The COURT: What does this prove, these four exhibits? Because somebody else thought it was?

Mr. NORTH: This shows, your Honor, that unincorporated funds have been treated as investment companies for purposes of the 1940 Act since the early days when the Act was first adopted—I think this Alexander Fund one is dated 1940 or maybe 1941.

The COURT: Treated by whom?

Mr. NORTH: By the persons who operate the funds, and by the Securities and Exchange Commission, as the agency which administers the law.

The COURT: Do you object?

Mr. MCCAULEY: I object.

The COURT: The objection is sustained.

Mr. NORTH: Your Honor, the identification [42] I stated on the record related to 12–A only. I would like just for purposes of identification, to note that 12–B is a similar statement filed with the SEC by Securities Fund in April of 1941 and that 12–C is a similar statement filed by Mutual Investment Fund on October 24, 1940, and that 12–D is a similar statement of Amalgamated Investment Company filed with the Commission November 1, 1940.

I assume that the objection and the ruling apply to all four of them.

The COURT: Yes.

Deputy CLERK: Plaintiff exhibit 13 for identification.

(Plaintiff exhibit 13 is marked for identification.)

Mr. NORTH: I offer exhibit 13 as being a photostatic copy of a letter dated February 3, 1964 from A. R. Gustafson, Vice President and Actuary of the Company, United Benefit, which was submitted to us as being a copy of what they designate their annual report for the holders of this contract.

I offer it for that purpose.

Mr. MCCAULEY: No objection, your Honor. This was sent out pursuant to the terms of the contract.

The COURT: That may be admitted.

* * * * *

[43] Deputy CLERK: Plaintiff 14 for identification.

(Plaintiff exhibit 14 marked for identification.)

Mr. NORTH: Your Honor, I offer exhibit 14 as being a sample copy of the manner in which the so-called monthly accumulation rate is determined from month to month, as this flexible fund is operated. This particular [44] one is for the month ending December 31, 1963, but I believe it was cited to us as being typical of the manner in which that same thing is determined from month to month as these contracts go along.

Mr. MCCAULEY: With the understanding, your Honor, that these are the internal working papers of the company and they are not generally distributed to policy-holders, we would have no objection to them.

The COURT: They are received.

* * * * *

[58] ARNOLD PINES, a witness called by counsel for the plaintiff, having been duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

By Mr. McCLOSKEY:

Q. State your name and address for the record, will you, please? A. My name is J. Arnold Pines. I reside at 1405 Dillston Road, Silver Spring, Maryland.

Q. And your present position? A. Associate Director in the Division of Corporate Regulation of the Securities and Exchange Commission.

* * * * *

[59] By Mr. McCLOSKEY:

Q. Tell us your last position immediately prior to becoming associate director. A. I was chief financial analyst in the Division of Corporate regulation in the SEC.

Q. How long had you held that position? A. Since March, 1959.

Q. Prior to that what was your position? A. For approximately three years I was also Chief Financial Analyst, but it related only to the activities of the Division under two of the three statutes with which it is interested, namely, the Public Utility Holding Company Act of 1935, and Chapter 10 of the Bankruptcy Act. But in 1959 my duties as chief financial analyst became associated as well with the Investment Company Act of 1940.

Q. Do you hold any professional positions? A. Yes, I am a certified public accountant in the State of New Jersey, and I am a member of the American [60] Institute of Certified Public Accountants, as well as a member of the American Finance Association.

Q. Your duties in the Commission as a financial analyst, would you please briefly summarize what they are? A. I was the person chiefly responsible for the technical direction and development of matters of corporate finance and

accounting under the three statutes which I have named.

All the financial analysts and the accountants were responsible to me in connection with any matters having to do with corporate finance.

Q. Mr. Pines, I direct your attention to what has been marked as Plaintiff exhibit 16-A through 16-E and I ask you if you have ever seen these before? A. Yes, I have.

Q. Can you tell me what they are? A. They are photocopies of studies submitted to me and other members of the SEC staff on January 17, 1964 by representatives of United Benefit Life Insurance Company.

Q. Do you remember the persons who submitted them to you, the names of any of those persons? A. As I recall, they were Messrs. McCauley, Weisberg——

[61] Mr. McCauley: I will concede, that in an effort to get this case on trial after such a long delay—we decided to submit these things to the Commission and they were delivered.

Mr. McCloskey: Thank you. We will accept that.

By Mr. McCloskey:

Q. I show you plaintiff exhibit 17 for identification and ask you if you can identify that. A. Yes.

Q. What is it? A. This is a part of the material submitted to me and staff members, also on January 17, 1964, by the same persons.

Q. Mr. Pines, what did you do subsequently with these documents? A. I studied these documents at the request of Mr. Solomon Freedman who was then an associate director in the Division of Corporate Regulation, with a view to understanding and analyzing what the relationship was, if any, between the premiums paid in by contract purchasers and the guaranteed minimum cash value percents set out in Section 9 of the Flexible Fund annuity contract.

Mr. McCloskey: At this time, I offer plaintiff exhibit 17 into evidence.

[62] Mr. McCauley: I object to it, your Honor.

The COURT: You furnished it to them.

Mr. McCAULEY: We furnished that to them, reserving at that time, the right to object on the grounds of relevancy.

There surely is no question about it, that this material was furnished, but how it is conceivable that, because this company looked and made studies to make a determination of what historically would have occurred with respect to so-called market action, what the relevancy or materiality is to determining whether, in the insurance sense, under the Valic case, this company has assumed the risk, I, for the life of me, cannot understand.

Because these studies deal with general indices. The mere fact that indices go up—for example, the Dow Jones closed a little over 900 on Friday, but there are people who lost money in the market.

And the mere fact that we look at indices, does not determine whether or not in the sense set out in the Valic case, we take a risk.

I think there is no question about it that the Courts generally would take judicial notice of the fact that, if you invest in securities, there is risk. And the mere fact that over a period of time general indices have [63] indicated an uptrend, does not mean that (a) it is going to continue; or (b) that you should have participated in it.

So that our problems are not what happened in the past but what is going to happen in the future, and certainly no one is going to be able to predict that; and most of all, even if I attempted to predict it, this agency is the last one that would let me put it in a document and circulate it.

As they would not permit Valic, or Ealic to circulate it.

The COURT: It may be admitted.

Deputy CLERK: Plaintiff exhibit 17 marked into evidence.

(Plaintiff exhibit 17 marked in evidence:)

By Mr. McCLOSKEY:

Q. Can you tell us, briefly, what is contained in these large books that you have before you—first of all, how many studies are there? A. There are four studies and

the one which is designated as Plaintiff exhibit 16–E and representing United Benefit's study No. 4, actually has 5 sub-studies in it.

Q. Did there seem to be an order to these studies? [64] A. Yes. Study No. 1, identified here as Plaintiff's Exhibit No. 16–B—pardon me.

Study No. 1, Part 1, identified as Plaintiff's Exhibit 16–A, is an annual premium study covering the 80-year period from 1880 through 1959, and for decreasing, consecutive decreasing time periods, as 1881 through 1959, 1882, through 1959, and so forth, down to the single year 1959.

Q. What information is shown on that briefly, without—what kind of information can you read from the study? A. That study shows the net premium after deduction of load invested each year by a hypothetical contract purchaser in a hypothetical fund investing in a pool of securities governed in its market action by a selected index of common stock prices and yields.

Q. What is the next study? A. The next study identified as Plaintiff's exhibit 16–B, is also Study No. 1, but Part 2, and it is different in that rather than being based upon an annual premium payment, it is based upon a single initial premium, and it covers the same periods of years as the one to which I have just referred.

Q. And the next study? A. The next study identified as plaintiff's Exhibit 16–C, is Study No. 2, and is a monthly premium study covering [65] the years 1928 through 1960, by months, and then consecutively decreasing time periods as 1929 through 1960, 1930 through 1960, et cetera, down to and including the single year 1960.

Q. And what information can be read from this study? A. The same general type of information can be read from this as from the prior studies, namely, the rate of accumulation of a fund, invested in an index of common stocks with yields on the portfolio securities, identical with that of the selected index, and showing as the other studies the cash value of the fund at the end of the respective periods.

Here months, and in the previous ones years.

Q. Tell us about the next study, please. A. The next study, identified as Plaintiff's exhibit 16-D, is also a monthly premium study, but it encompasses a different time period.

It covers the period 1937 through 1961 and, again, decreasing, consecutively decreasing time periods as 1938 through 1961–1939 through 1961 and so forth down to and including the single year 1961.

The type of information shown here in these electronically prepared sheets is generally the same as that shown in the other studies.

Q. That is, it is a study of the action of a [66] hypothetical fund? A. Of a hypothetical fund invested in a pool of common stocks behaving in the market in accordance with a selected index of common stocks.

Q. And will you please tell us what the last study that you have there in your hands is. A. The last study, identified as Plaintiff's exhibit 16-E, is what I have referred to as Study No. 4. It consists of—unlike the other studies—manually prepared accounting work sheets and is based upon what I would consider to be five sub-studies from the material submitted to us by the defendant's representatives.

Q. This is back-up material, then. I will show you exhibit 17, and refer you to the page in the center thereof which is marked—I notice the number on the page is on the back. Will you tell us where that number was derived? A. In plaintiff exhibit 17 the pages did not have numbers on the face of them, and I have directed my secretary to number them on the back so as not to deface the front of the pages.

Mr. McCloskey: If your Honor please, we would like to refer to those numbers, there being no other numbering system available for this 23-page document.

[67] If it will be all right with you, we will use those numbers on the back of the pages.

The Court: All right.

By Mr. McCLOSKEY:

Q. Referring now to page 9 of 23 pages——

The COURT: What's that?

Mr. McCLOSKEY: Page 9, your Honor. It is numbered in the upper left, and it would be the face side of that.

The COURT: I see. I have it.

[68] By Mr. McCLOSKEY:

Q. With reference to this page, you will see "1–A" up in the righthand corner, and will you please tell us what that means, Mr. Pines? A. That number appeared on this sheet when it was given to me, and I have, therefore, in my study of the company's studies, treated that as sub-study "1–A."

Q. Will you please tell us what the chart on this page depicts as relates to the material which you examined? A. The chart on this page 9 shows the increases or decreases in terms of percentages in the market price of the Moody's Index of 125 Industrial Common stocks from one year to the next, the period being 1935 through 1944.

Q. Moving on, then, to what would be page 11, the front side of page 11, I see a chart at that point in the study. Do you see it? A. Yes.

Q. Can you please tell us first of all, what this chart depicts—what are these top lines, what do they appear to be? A. Those figures are the index prices of Moody's 125 industrial common stocks for the years indicated.

[69] I should point out that, as I understand these figures, the term "market entry" and the term "market term value" presumably meaning market terminal value, representing the average prices in the year for the Moody's 125 Industrial Commons, except that they are delayed one year. The market terminal value, for example of 42.40 shown as the ending figure for the year 1935, is actually an average of 12 monthend-index prices for 1936 and treated as the end of 1935, in that procedure and that procedure applies throughout these remaining years.

Q. The next figure directly below the 42.40 that you

showed, represents what? A. That is the percent of increase or decrease here shown, appreciation or depreciation, for example, the difference between 30.09 and 40.40, or 12.31 points represent an appreciation in the market price of the index of 40.9 per cent.

Q. The next figure next to that in parentheses? A. 0.9 per cent.

Q. Right. A. That is a depreciation from 42.40 to 42.04.

Q. Directing your attention to the center of the page there is a large block of numbers. It seems to be some sort of a graph or table. A. Yes.

[70] Q. And to the far left it says "Investment Distribution Stocks and Bonds."

Will you please tell me what this chart represents? A. This big block on this page 11 represents the results of applying varying assumptions as to how the accumulated net premium will be invested as between common stocks and bonds.

Mr. McCauley: Well, if your Honor please, now I have not interrupted up to this point, but this is either obvious from the paper, or we told them—I do not remember telling them—it just seems to be obvious from the paper.

Now, if we are going to go over all these, pointing out these things, it is perfectly clear, I think, everything he has said, and everything he has explained, right on the face of the paper.

The Court: I would think the exhibit would speak for itself.

Mr. McCauley: Yes.

Mr. McCloskey: We are attempting to explain. To our mind, your Honor; it seemed to me that there was quite a mass of figures without too much designation as to what they meant.

That is what the function of Mr. Pines is here, to show—to the extent that they are related to the [71] back-up material and to what these numbers represent.

They are just numbers unless they are related to the various different items in the studies.

The Court: All right. Go ahead.

The WITNESS: For example, in the first line, representing 100 per cent stock investment, and nothing in bonds, at the end of 1935 there is a figure of 141.98.

That simply means that the cash value of the fund at that date would have equaled 141.98 per cent of the net premium invested by the fund.

By Mr. McCLOSKEY:

Q. Mr. Pines, I notice that as you run down that column, the figure changes. Will you explain that change and what it means? A. Yes. As the proportion of the funds, moneys, are increasingly invested in bonds, you will note that the per cent of appreciation tends to decline, and conversely, as the percent invested in stocks increases, the percent of appreciation tends likewise to increase.

On the other hand, where there is a drop in the market, as, for example, take the year 1937, 100 per cent investment of the moneys of this fund in stocks results in that year in an 87.92 per cent relationship between cash [72] value and accumulated net premium.

That is, there is a deficiency. But, as you run your eye down that column, you will note that, as the per cent of moneys invested in bonds increases down to a maximum of 70 per cent of the moneys invested in bonds, the ratio of cash value to accumulated net premium increases; thereby indicating that the market swings from highs to lows find greatest emphasis in the situations where moneys are invested in stocks, whereas when moneys are invested in bonds, it tends to have a cushioning effect upon the, what otherwise would be, wide swing in the market.

Mr. McCAULEY: I object to the statement of his opinion about the cushioning effect.

The COURT: Sustained.

By Mr. McCLOSKEY:

Q. Mr. Pines, I request you to turn to page 20 of this 23-page document. There is a chart on page 20, on the face side of page 20, and in the upper righthand corner there

is a Roman numeral V. Will you please tell us what that Roman Numeral refers to first? A. That number appeared on this sheet when it was given to me, and I have treated that sheet, as well as the three [73] remaining sheets, as being sub-study V of the Company's study No. 4.

Q. Will you tell us what this chart represents? A. Yes, this chart represents the maximum amounts of decline in the market prices of the index of Moody's 125 Industrial Commons, for the period 1933 through 1960, although the heading on this says, "1929 through 1960."

Mr. McCauley: I do not understand the comment, your Honor.

The Court: He says the heading says "1929 through 1960." But the table shows the year 1937 to 1947.

By Mr. McCloskey:

Q. Would you explain your last comment—does that relate to some of the back-up material that you have there? A. Yes, it does. The company excluded from its consideration for the purposes of this chart the period 1929 through 1932.

There is then left the period 1933 through 1960.

On the basis of an examination of that period, 1933 through 1960, the company computed the maximum per cent of decline from high to low, for a one-year period within that span of years, 1933 to 1960, the maximum per cent of decline for any two-year period, not necessarily [74] coinciding with that same one-year period, also from 1933 to 1960, and so on down until the point where they computed the maximum per cent of decline for a ten-year period, namely, 1937 through 1947, as it worked out to be.

Q. And does this chart represent the worst periods, the worst drop periods, 1, 2, 3, 4, 5 year, et cetera? A. Yes.

Q. During that entire period? A. Yes. Those per cents of decline shown in the last column to the right represent the worst drop in the averages, namely, the Moody's 125 Industrial Common Stock Index, for these one-year, two-

year, three-year, et cetera, periods down to and including the ten-year period.

Q. Will you tell us where these materials derive from? Is there something else in the study? A. Yes. This is—these figures can be verified by reference to Sheet No. 8 in that same group of sheets.

Q. I ask you to turn to the following page, No. 21. Will you tell us then what these charts represent on 21? A. On page 21 the company carried forward the label "Worst drop in Averages over the Period," because they were confining their inquiry at this point to these [75] same time periods of one year, two years and so forth.

They then computed what the cash value of the fund would be if invested in Moody's Index—rather, let me put it this way:

They then computed what the cash value of a fund would be if the market experience of the fund coincided with these maximum per cents of decline, and if it were further assumed there would be a 3 per cent dividend yield on the cost of the securities purchased by such a hypothetical fund.

The figures supporting the second column of the upper half of page 21 appear in the next sheet 22, marked up in the corner by the company as exhibit "X"—shows on Exhibit X, for example, taking the end of a five-year period, that the cash value of a fund which experiences the worst drop in averages for a five-year period, would be equal to 71.5 per cent of the accumulated net premium.

That figure of 71.5 percent is brought forward on to this page 21 and shows up on the line designated "Five-Year."

Q. What assumption was made with respect to this fund—in what kind of a portfolio was this fund to be invested? A. It was assumed that this fund would be totally [76] invested in common stocks and no other securities.

Q. I see this study, page 21. This is the document as it was furnished to you by the Company? A. Yes, sir.

Q. And the headings on that page are the Company's headings and not yours? A. Right. I did not mark these exhibits in any way, no, sir.

Q. Mr. Pines, are you familiar with the terms of the policy, Flexible Fund Contract which is in evidence here? A. I am generally familiar with various of the provisions.

Q. With respect to the minimum guarantees which are contained, or stated in that policy, are you familiar with those? A. Yes.

Q. Have you examined them with respect to the suggested guarantee on page 21 of this exhibit? A. Yes.

Q. Is there any difference? A. They are identical.

* * * * * *

[77] The WITNESS: When I said that the guaranteed minimum cash value per-cents set out in the Flexible Fund Annuity are identical with those shown with these suggested guaranteed percents shown on page 21, I had reference to the upper half of page 21.

By Mr. MCCLOSKEY:

Q. What is the difference between upper half and lower half on page 21? A. The upper half is based upon an annual premium payment by the contract holder, and the lower half is based upon a single premium payment by a contract holder.

* * * * * *

[81] Mr. MCCAULEY: If Your Honor please, Mr. North had offered certain of our responses to requests for admissions, and responses to a supplemental request for admission, and I said that we would review them, and I would like to make some statement on the record with respect to some of them.

In the request for admission, Number 1, in our view that must be read in light of the stipulation Number 1, which is Plaintiff's Exhibit Number 1 dated December 23. We have nothing to add on Numbers 2, 3, or 8.

In Number 24 we incorporated the response to Number 23. Number 24 begins with the words, "On the basis of studies [82] made by it . . ."

There were no studies made by the defendant other than those which have been offered here and admitted. Those studies do not really—there is nothing in those studies that deals with the statement and the request for Number 24, and there has been, in our view, no admission of that and no admission of Number 24.

Number 27—28, excuse me—27, 31 and 34—we have no further comment on those.

With respect to Number 40, I should like to point out, so that it will be clear, that this request speaks as of December 31, 1962, and a reference to any particular contract, and if you go back to the time when we first wrote these contracts—I think it must be read in the light of the fact that the guaranteed minimum cash values do increase, so that as of the period of ten years the guarantee is at one hundred percent, and the figures here do not necessarily reflect what would happen throughout the term of the contract.

Number 44, we have no further comment.

Number 45, we deny the truth of the matter as stated, and then admitted as follows:

"The defendant admits that following extended discussions based on such studies it was concluded [83] that defendant would undertake the various guarantees made by defendant in the APFFRA policy."

And we would like to urge and reserve the fact that this should not preclude us from offering testimony with respect to these guarantees.

What the defendant, in effect, was saying was the discussions were based on the studies. The conclusions, it is our position, were based on judgments made by the management and the board of directors of the company.

49 and 50, we have no further comment.

* * * * *

[85] The Court: Mr. North, I would like to ask a couple of questions.

Mr. NORTH: Yes, Your Honor.

The COURT: I have before me Plaintiff's Exhibit Number 2, which is a sample policy. At the time the policy holder takes out this policy there is fixed the cash surrender values of the policy at the ends of certain years. For instance, let's say at the end of six years, premiums paid for in six years, if you want to cash the policy in you get seventy-five percent of what you put in; is that correct?

Mr. NORTH: I think it is seventy-five percent of the net premiums.

[86] The COURT: I know, but——

Mr. NORTH: Not seventy-five percent of what you actually paid in.

The COURT: But it is fixed as of the time you take the policy.

Mr. NORTH: The minimum guarantee is fixed; correct.

The COURT: Now, let me ask you: if the flexible fund makes money during those six years, does that increase the percent that the policy holder will receive?

Mr. NORTH: Definitely.

The COURT: Now, if the flexible fund loses money, the policy holder would still get seventy-five percent net; right?

Mr. NORTH: Yes. Those figures——

The COURT: The policy holder doesn't lose.

Mr. NORTH: He doesn't lose beyond what he has already lost when you get to those figures.

The COURT: That is what I am talking about.

Mr. NORTH: That's right. You are correct, Your Honor.

The COURT: Now, at the maturity date I decide that I want to purchase this so-called annuity whereby I will receive a certain sum of money monthly for the rest of my life.

[87] At the time I take the annuity that lump sum is fixed; right?

Mr. NORTH: That is correct.

The COURT: Now, if the flexible fund makes money, I get a bigger monthly payment; correct?

Mr. NORTH: Yes, sir.

The COURT: If it loses money, I still get the monthly

payment that is agreed upon at the time I take out the annuity; I don't lose.

Mr. NORTH: You don't lose below the minimum guarantee; correct.

The COURT: So that in this policy the risk is upon the insurance company.

Mr. NORTH: The risk is upon the insurance company to the extent of its minimum guarantee.

The COURT: All right.

* * * * *

RULING OF THE COURT

[94] The COURT: The Supreme Court in VALIC says that the difficulty is that absent some guarantee of fixed income the variable annuity places all the investment risk on the annuitant and none on the company. The holder gets only a pro rata share of what the portfolio of equity interests reflects, which, says the Supreme Court, may be a lot, a little, or nothing.

VALIC also says, in referring to the policy in VALIC, that the companies that issue these annuities take the risk of failure, but they guarantee nothing to the annuitant except an interest in a portfolio of common stocks or other equities, an interest that has a ceiling but no floor.

VALIC also says that in hard reality the issuer of a variable annuity that has no element of a fixed return assumes [95] no true risk in the insurance sense.

We deal with a more conventional concept of risk-bearing when we speak of insurance, for in common understanding insurance involves a guarantee that at least some fraction of the benefits will be payable in fixed amounts.

In this case under the FFA policy the defendant insurance company guarantees to the annuitant a fixed dollar equal monthly retirement income after the maturity date is reached, which income cannot be outlived.

The evidence presented by the Government, including the admissions made by plaintiff, satisfies this Court that the FFA policy is not a security. The guaranteed minimum

cash value of the FFA policy provides a guaranteed basic fixed dollar monthly equal retirement income, which income cannot be outlived, as I have stated, by the annuitant.

I hold, therefore, that the FFA policy is, therefore, an insurance product within the interpretation of VALIC, and the motion to dismiss is granted.

• • • • •

PLAINTIFF'S EXHIBIT No. 1

[Title omitted]

STIPULATION

It is hereby Stipulated and Agreed as of this 23rd day of December, 1964, among the undersigned counsel for the parties, as follows:

1. Interrogatories numbered 1 to 8 included in Appendix A attached to this Stipulation shall be deemed to have been filed with the Clerk of the Court, and served by the plaintiff upon the defendant in accordance with Federal Rule of Civil Procedure 33.

2. The answers to interrogatories number 1 to 8 included in Appendix A attached to this Stipulation shall be deemed to have been filed with the Clerk of the Court, and served by the defendant upon the plaintiff in accordance with Federal Rule of Civil Procedure 33, except that the defendant does not waive its right to object to the use by the plaintiff of the answers (or any parts thereof) upon any ground including the ground that the answers (or any parts thereof) are irrelevant.

/s/ WALTER P. NORTH,
Associate General Counsel,
Securities and Exchange Commission,
Washington, D. C. 20549.
Attorney for Plaintiff.

DAWSON, GRIFFIN, PICKENS & RIDDELL.
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Of Counsel:
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BLANK, RUDENKO, KLAUS, & ROME,
1660 Suburban Station Building,
Philadelphia, Pennsylvania 19103.

Appendix A

1. *Interrogatory:*

What steps are taken by the defendant to offer to the public and to place what the defendant designates as an FFA [Flexible Fund Annuity] "policy" in the possession of the owner thereof?

Answer: The defendant makes the FFA policy available only through those of its General Agents and Soliciting Agents who meet the standards established by the defendant as to (a) the dollar volume of the Agent's production of life insurance, and (b) the Agent's attendance at, and successful completion, of a course of study dealing with the FFA policy.

Agents who successfully complete the course of study are furnished with visual aid "sales" materials, and thereafter interview prospective policyholders. The visual aid materials are furnished to the Agent so that he will have explanatory materials available in discussing the FFA policy with a prospect. At the present time Agents are permitted to discuss the FFA policy with prospects in the States of Nebraska, Colorado, Utah and Montana.

The applicant is given a copy of an explanatory brochure generally describing the terms of the FFA policy. (A copy of this brochure was earlier furnished to the plaintiff and is attached to the complaint. Specimen copies of the visual aid materials were furnished earlier to the plaintiff.) If the prospect is interested and executes an application, the latter, together with the first premium, is forwarded to the defendant.

Following a review of the application, the defendant determines whether to execute an FFA policy and deliver it to the applicant. If a policy is executed, the defendant usually delivers the policy to the defendant's Soliciting Agent through the General Agent for eventual delivery to the applicant.

In (a) transmitting the visual aid materials and the explanatory brochure to Agents, and (b) in transmitting

the application to the defendant, and (c) in delivering the FFA policy to the applicant, the United States mails are used within the State of Nebraska and across State lines.

2. *Interrogatory:*

How are the bonds of the defendant which have been allocated to the Flexible Fund A account valued? How are the bonds of the defendant which are not allocated to the Flexible Fund A account valued?

Answer: Bonds which have been allocated to the FFA Account are valued at market. Bonds which have not been allocated to the FFA Account are valued generally at amortized values, although certain bonds—designated yearly by the National Association of Insurance Commissioners—are valued as directed by it, which value generally approximates market value. These bonds consist generally of bonds in default or or such quality that the market value is generally below the value which would be reached by amortization.

3. *Interrogatory:*

Describe all of the types of communications which are sent by the defendant to holders of FFA "policies."

Answer: The following are sent to FFA policyholders: (a) premium notices, (b) grace period expiration reminders, (c) special reinstatement offers, and (d) the Annual Report referred to in the FFA policy. A specimen copy of the Annual Report for 1963, sent to policyholders in 1964, was earlier supplied to the plaintiff. Specimen copies of the other items are being supplied to the plaintiff.

5. *Interrogatory:*

Describe the steps in computing the Monthly Accumulation Rate in connection with FAA "policies."

Answer: The calculation of the Monthly Accumulation Rate involves arithmetical operations which can be summarized as follows:

(1) + Market value of bonds.
(2) + Market value of stocks.
(3) + Accrued interest.
(4) + Dividends declared but not received.
(5) + Other assets.
(6) — Reserve for defendant's income taxes allocable to Flexible Fund A Account.*
(7) — Net premiums received during month.
(8) + Policy benefits paid and expenses charged.

N Numerator—algebraic sum of items (1) through (8) at the end of the month.

D Denominator—algebraic sum of items (1) through (6) at the end of the previous month.

$$\text{Accumulation Rate} = (.99917)\frac{N}{D}$$

6. *Interrogatory:*

What reserves are maintained in connection with FFA "policies"?

Answer: The reserves maintained fall into two categories—policy reserves and other (non-policy) reserves.

At present policy reserves held in connection with FFA policies consist of (a) the aggregate Cash Values of FFA policies, which reserves are maintained in an account within the FFA Account, and (b) a contingency reserve to cover the Guaranteed Minimum Death Benefit, which reserve is maintained in an account without the FFA Account.

Among the other (non-policy) reserves, maintained in an account within the FFA Account, are reserves, (a) for

* Item (6) = 25% of total unrealized capital gains. Paid capital gains taxes would reduce this reserve. (Subject to the possible amendment of and to the interpretation of federal incom tax law.)

possible capital gains taxes, and (b) for the so-called "actuarial margin" for the current month.

Among the other (non-policy) reserves, maintained in an account without the FFA Account are reserves (a) for premiums paid in advance, and (b) for unpaid commissions and expenses.

When the Accumulated Value of an FFA policy is less than the Guaranteed Minimum Cash Value, the defendant sets up an additional reserve in an account without the FFA Account equal to the difference between the amount of the Accumulated Value for the given policy and the Guaranteed Minimum Cash Value of that policy.

7. *Interrogatory:*

What is the significance of the figure for "surplus" which appears in the informal monthly memoranda prepared by the defendant in connection with the Flexible Fund A account.

Answer: This figure represents a portion of the defendant's Unassigned Surplus which was allocated to the FFA Account at the outset. The figure is calculated by subtracting from the value of the assets allocated to the FFA Account, the current Accumulated Values of FFA policies and other liabilities (the current month's untransferred actuarial margin and the reserve for income taxes).

As of December 31st of each year, this figure is formally reflected in the Annual Report of the defendant prepared in accordance with the instructions of the National Association of Insurance Commissioners.

8. *Interrogatory:*

What reserve for mortality is maintained by the defendant in connection with FFA "policies"?

Answer: The defendant maintains a contingency reserve in an account without the FFA Account to cover the Guaranteed Minimum Death Benefit. As of December 31, 1963, the amount of this reserve was $204.00.

* * * * *

PLAINTIFF'S EXHIBIT No. 9

September 13, 1962

Form 560, Series 114L
Annuity Policy
Form 26L 1-62
Special Annuity Application

Mr. Guy R. Whitten,
Deputy Commissioner,
Insurance Department,
State of Maine,
Augusta, Maine.

Dear Mr. Whitten:

Mr. Pearce has sent us a copy of your August 29, 1962, letter to him, relative to these forms filed with your office last April.

From reading the summary of the Insurance Department comments regarding our Flexible Fund Annuity, it seems to us that we have failed to make a clear and concise statement of the nature of this policy. Actually, it differs from the conventional Deferred Retirement Annuity, such as our Form 523, in only one significant respect. Under the conventional form, net premiums are accumulated at neither more than nor less than some fixed rate, such as two and one-half per cent. Under the Flexible Fund Annuity, very similar net premiums are accumulated at a rate determined by investment results, with the guarantee that the aggregate rate at any time shall be not less than zero per cent, even though investment results may be adverse. Any other differences between this policy and the traditional policy are merely incidental and arise out of this primary difference.

In view of this single pertinent difference, it seems to us that the Insurance Department's comments would fall in two categories. For the first, relating to insurance risk, we would say that the risk under this policy is identical to that under the traditional annual premium retirement

annuity. So far as this Company is concerned, we have an identical death benefit under the Flexible Fund Annuity and under our regular APDRA policy. This death benefit constitutes insurance in the one case to exactly the same degree that it does in the other. We would not say that guaranteed cash values constitute an insurance risk in either case. In the traditional form, the guaranteed cash value is equal to the reserve accumulated from net premiums, with sometimes a surrender charge during the early years. Under the Flexible Fund Annuity, the cash value is the accumulation of net premiums with significant minimum guarantees, but we would not say that such guaranteed values constitute an insurance risk in either case.

[2] The other area in the comments as furnished to us concerns the possibility of impairment of the Company's solvency. While this is a legitimate concern, it must be viewed in the light of the stockholder's equities currently exceeding $50,000,000.00, which would have to be dissipated before any policy reserves would be in jeopardy. Any insurance company must be soundly managed to survive over a period of years. Improper underwriting practices arising from volume pressures could initiate a drain which would threaten solvency, and there are many other areas just as susceptible to management failure. In the particular area under consideration, we feel it is a management problem and responsibility to maintain a reasonable and safe balance between the volume of ordinary insurance and Flexible Fund Annuity, within the limits imposed by stockholder surplus. Without detracting from the responsibility of Company management in this area, we have a feeling that this area will also be closely watched by Insurance Departments beginning with the direct and continuous regulation of the Nebraska Insurance Department, and supplemented by triennial convention examinations. This does not mean that this area of management should be denied to responsible companies.

Both our traditional Annual Premium Deferred Retirement Annuity and our Flexible Fund Annuity are integral

and continuous policies, covering both the "pay in" and the "pay out" periods. It has not been our impression that any Insurance Department disclaimed jurisdiction over a conventional annuity during the accumulation period, on the basis that the insurance elements during such period were relatively small. The Flexible Fund Annuity contains exactly the same insurance elements during that period. In either case, there seems to be no question of the insurance element when the policy becomes a "true annuity" at the time it goes into benefit. If jurisdiction is to exist at that point, it would seem to obtain over the previous 20 to 40 years that the policy may have been in force.

We fully recognize that the flexible feature of this policy during the accumulation portion of its duration involves some breaking away from tradition. That is not necessarily bad in itself, but it does necessitate study and rethinking of problems. We hope that you will think through this matter [3] with us, to the end that the insurance industry may retain some flexibility in adapting to current conditions. This is a retirement annuity policy, and we have a strong feeling that provision for income after retirement is not only a proper insurance company function, but that it should be under the exclusive supervision of the State Insurance Departments.

We would be happy to go into any of these factors further with you, and would appreciate hearing from you.

Very cordially yours,

C. W. BUCKNAM,
Assistant Vice President.

LA

H. A. PEARCE.

PLAINTIFF'S EXHIBIT No. 10

May 16, 1962

Form 560, Series 114L
Annuity Policy
Form 26L 1-62
Special Annuity Application

Honorable Sam N. Berry,
Commissioner of Insurance,
State of Colorado,
State Office Building,
Denver 2, Colo.

Attn. Nathan D. Thompson, Examiner.

Dear Mr. Thompson:

In submitting these forms, regarding which you wrote us on May 11, 1962, we have every intention of being in compliance with S. 289, approved May 1, 1961, which we believe has been codified as section 72-2-14 C. R. S. 1953, amended 1961. If these are not the same statutes, please let us know in order that we may secure a copy of the section referred to.

Up to now, we have found rather general acceptance of the word "Flexible" as having exactly the same connotation as the word "variable". It would seem to us that the term "Flexible Fund" in block letters and a contrasting color, as a part of the policy title on the first page, would satisfy the requirement of paragraph one of Bulletin Number 35. If the Colorado Insurance Department feels that this does not constitute compliance, we could insert a rubber stamp impression in the open space at the bottom of page one, and would suggest the following wording:

VARIABLE BENEFITS UNTIL MATURITY
SEE THIRD PARAGRAPH ABOVE

We recognize the regulation in Colorado, as in several other states, requiring that any agent who is to sell this

type of business must take a special examination conducted by the Insurance Department. Upon approval of our form in Colorado, agents who have met Company requirements, as commented on in our letter of April 19, 1962, will be required to qualify for special licenses before soliciting any of this type of business.

We believe that our policy and methods of operation qualify under section 72-2-14 C. R. S. 1953, amended 1961, and with Bulletin Number 35. We will appreciate your further comments [2] in order that we may do whatever additional may be necessary.

Very cordially yours,

C. W. BUCKNAM,
Assistant Vice President.

LA

PLAINTIFF'S EXHIBIT No. 11

May 14, 1962

Form 560, Series 114L
Annuity Policy
Form 26L 1-62
Special Annuity Application

Hon. Zack D. Cravey,
Commissioner of Insurance,
State of Georgia,
Atlanta 3, Ga.

Attn. Mr. John Cook.

Dear Mr. Cook:

It was most thoughtful of you to phone us last Wednesday. While I had not related our Flexible Fund policy to Section 56-2508 of the Georgia statutes and was not prepared to discuss such relationship when you called, I believe I have a better understanding of your thinking and of your questions, after having talked about this, than might have developed from correspondence.

It would appear to us that Section 56-2508 was intended to refer to the type of provisions discussed in Mr. Cravey's bulletin dated June 24, 1958, and to prohibit special tontine funds or arrangements under which the policyholder purports to share in the profits from the operation of the company to a greater extent than do policyholders in general. While our Flexible Fund Annuity is prima facie not the type of policy to which either one of these restrictions would apply, we must look further to determine whether this section does in fact apply to this form.

Section 56-2508, by its beginning paragraph, refers to any benefit, plan or agreement which is in *addition to* the rights or benefits provided by a basic life policy. The Flexible Fund Annuity is complete within itself and neither contains nor implies any benefits other than those provided in the base policy. [Illegible.] It would, therefore, appear

that this section was not intended to apply to such a policy, but since there is some obscurity in the wording of this paragraph, an analysis of the subsequent paragraphs may be fruitful.

We believe it would be agreed that paragraph (1), (2), and (4) have no relevance in this situation. Interpretation of paragraph (3) is not so easy.

Paragraph (3) seems to say that no funds or money, other than the normal reserve required to meet the contractual guarantees of the policy, shall be placed in a special or segregated account for distribution to holders of such policies. This applies whether such funds arise from a portion of the premium, from dividends, from lapses, excess interest, or from any other source. Our policy [2] is specific as to the net premiums credited to the separate account and the basis of accumulation of such net premiums. Such accumulation constitutes the normal reserve. No holder can receive any distribution from this account other than the accumulation of his own deposits to the account. Any amount by which a guaranteed minimum value may exceed such accumulation is guaranteed by the Company and will be paid from general company funds.

This analysis was made jointly with, and is concurred in by, the Associate General Counsel of the Company. We are convinced that the policy in question is in compliance with Section 56–2508, but that such compliance is not relevant because this section was not intended to cover this type of policy. Chapter 56-25 applies only to life insurance policies. This is an annuity policy governed by Chapter 56–26.

In the course of our conversation on Wednesday, we also discussed the methods of determining and applying the accumulation rate. The attached sheet may help to clarify the policy wording in this regard.

Taking figures on an entirely hypothetical basis, this might be illustrated as follows:

	4/30	5/31
Market value—stocks	$75,000	$77,000
Market value—bonds	25,000	25,500
Accrued interest and dividends	500	600
Uninvested cash (Flow)	500	1,000
	$101,000	$104,100
May Net Premiums		−3,000
May Withdrawals		+ 400
		$101,500

$$\text{Accumulated Rate} = \frac{.99917 \times 101{,}500}{101{,}000} = 1.004116$$

Since the accumulation rate must reflect the investment results during the month, and any cash investment income as well as net premiums or withdrawals are reflected in either an investment account or in uninvested cash on the last day of the month, such premiums must be taken out of, and withdrawals put back into, the numerator so the resulting accumulation rate will represent investment results. We have emphasized the fact that it is entirely possible for the rate to come out to be less than unity for any individual month.

From the standpoint of an individual policy with an accumulation of $1,000 on April 30 and a $100 net premium due May 1: If the May 1 premium is paid by May 10, it is accumulated from the first of the [3] month, so the May 31 value would be ($1,000 + $100) × 1.004116, or $1,104.53. If this premium is paid after May 10, the May 31 value would be ($1,000 × 1.004116) + $100, or $1,104.12.

We apologize for this letter having necessarily become somewhat long. The points which you raised certainly must be resolved, and we hope this will help. If there are other questions, either on these points or on other points, we hope to have the opportunity of discussing them with you. If it develops that such questions may be resolved more expeditiously by our visiting with you in Atlanta, we will be happy to do so.

Very cordially yours,

SS
Enc.

C. W. Bucknam,
Assistant Vice President.

PLAINTIFF'S EXHIBIT No. 13

[Letterhead of United Benefit Life Insurance Company]

February 3, 1964

N. M. Longworth President
Omaha, Nebraska

Mr. John Ublic,
Omaha, Nebraska.

Annual Report For Annuity Policy Specimen

Dear Mr. Ublic

The retirement income plan represented by your annuity policy is a *long-range program* by which you intend to secure for yourself a guaranteed fixed monthly income after retirement. It is a program in which you pay premiums to the Company until the maturity date which has been selected by you, and after such maturity date the Company pays you a fixed monthly retirement income; an annuity income which you cannot outlive, and which cannot be less than the annuity income based upon the guaranteed minimum cash value of your annuity on the maturity date.

The Company contracted to send this Annual Report in order that you be aware—even at the present time when your annuity has been in force only a relatively short time—of the value of contractual rights contained in your annuity. These rights include not only the guaranteed minimum cash value, but the accumulated value of your annuity which is based upon the value of common stocks and other investments owned by the Company and accumulated dividends or interest thereon allocated to a separate account maintained by the Company, under Nebraska law, in connection with your annuity and other similar annuities.

Your annuity provides for a *guaranteed minimum death benefit*, an amount equal to the sum of the full premiums paid by you. The amount of the premiums paid by you up to December 31, 1963, totals $2,200.00.

Your annuity provides for a *guaranteed minimum cash value* computed as a percentage of the *net* premiums paid by you, in accordance with paragraph 9 of your annuity. After your annuity shall have been in force for 10 or more

years, the guaranteed minimum cash value will be 100 per cent of the net premiums.

[2] Your annuity provides for an alternative cash value—the *accumulated value* determined by a monthly accumulation rate provided for in paragraph 12 of your annuity. This accumulation rate is based upon the changes in value of the common stocks and other investments owned by the Company, and dividends or interest derived therefrom, allocated to the separate account.

The amount of net premiums attributable to your annuity as of December 31, 1963, was $1,505.00.

As of December 31, 1963, the accumulated value of your annuity was $1,631.94.

Your annuity guarantees that after the maturity date, you will receive a fixed monthly retirement income determined by the amount of the guaranteed minimum cash value of your annuity on the maturity date. In addition, a valuable feature of your annuity is the Company's unconditional and unqualified obligation to pay you a *higher* fixed monthly income after maturity in the event the accumulated value of your annuity on the maturity date is greater than the guaranteed minimum cash value.

We are pleased that the Company's investment experience in connection with the separate account, as reflected above, has thus far been favorable. The Company is optimistic about the likelihood that on the maturity date the accumulated value of your policy will be higher than the guaranteed minimum cash value, despite monthly or yearly fluctuations in the market value of the common stocks and other investments of the Company allocated to the separate account.

Sincerely,

/s/ DALE R. GUSTAFSON,
Vice President and Actuary.

LW

When writing about your policy, please give number.

United Benefit Life Insurance Company—One of America's Leaders

Plaintiff's Exhibit No. 14

Flexible Fund Annuity Account
December 31, 1963

Assets		Liabilities	
Cash	$ 46.36	Policy Accumulations	$110,159.69
Bonds (Market)	87,194.15	Actuarial Margins	229.76
Stocks (Market)	196,465.42	Accrued Income Tax	3,892.33
Accrued Int.	1,119.62		
Declared Div.	1,464.78	Surplus	172,008.55
Total	$286,290.33	Total	$286,290.33

	December 1963	1963 to date	1962	Total to 12/31/63
Cost of securities	$ 10,802.25	$ 73,899.91	$200,952.05	$274,851.96
Market value of securities	14,541.41	95,948.89	187,710.68	283,659.57
Market gain (loss)	$ 3,739.16	$ 22,048.98	$(13,241.37)	$ 8,807.61
Interest earned	310.10	3,282.20	2,130.62	5,412.82
Dividends earned	580.45	5,613.34	2,424.12	8,037.46
Income tax accrued	(664.63)	(3,316.11)	(576.22)	(3,892.33)
Total investment results	$ 3,965.08	$ 27,628.41	$(9,262.85)	$ 18,365.56
Gross Premiums	6,785.00	95,155.00	66,135.00	161,290.00
Less				
Premium loadings	981.00	22,828.14	32,966.27	55,794.41
Actuarial margins	229.76	2,325.05	1,350.54	3,675.59
Withdrawals	0	1,009.46	108.11	1,117.57
Death benefits	0	3,051.74	18.51	3,070.25
Policy accumulations	6,233.96	75,926.33	34,233.36	110,159.69
Gain (Loss)	$ 3,305.36	$ 17,642.69	$(11,804.64)	$ 5,838.05

Plaintiff's Exhibit No. 14—Continued

	December 1963	1963 to date	1962	Total to 12/31/63
Contributed surplus			166,170.50	166,170.50
Current surplus			154,365.86	172,008.55

Accumulation rate 1.013690

For $100 monthly premium beginning March 1, 1962:

Gross premiums to December 31, 1963	$ 2,200.00
Net premiums to December 31, 1963	1,505.00
Accumulations to December 31,.1963	1,631.94

C. W. B.
1/17/64

PLAINTIFF'S EXHIBIT No. 18

April 19, 1962

Form 560, Series 114L
Annuity Policy
Form 26L 1-62
Special Annuity Application

Mr. Howard M. Gandee,
Deputy Commissioner,
Insurance Department,
State of West Virginia,
Charleston, W. Va.

Dear Mr. Gandee:

Recognizing that our Flexible Fund Annuity involved a few variations from traditional patterns, our initial filing of these forms was on a restricted basis in order that we might get an idea as to what additional requirements might be made. The response to the initial filing has been such that we have just recently extended our filing to most of the states.

At the moment we have direct specific approvals in the States of Arkansas, Montana, Nebraska, Nevada, Oregon and Washington. The State of Ohio has advised us that filing of such a form is not required, and the same is, of course, true in Hawaii.

Colorado has requested details of the application of the formula outlined in Paragraph 12, as well as copies of sales literature. We are enclosing copies of the material which we have just sent to Colorado, since it may be of interest to you as well. In connection with our sales program, sale of this form is strictly limited to agents who have attended a special two-day school and have passed an examination on it. No agent can attend this school without having completed our regular Life Insurance Schools and maintained certain minimum life insurance production and persistency requirements.

Connecticut has raised questions, particularly with re-

gard to the relationship of the guaranteed values to the separate account, and to the extent of the mortality element involved. These questions are being discussed with the Connecticut Department.

Illinois has currently withheld approval because of their [2] impression that holders of such policies participate in gains but not in losses. This is not the situation under our policy, the minimum guaranteed values being substantially less than the sum of the premiums particularly in the early years. This point is being discussed with Illinois.

The New Jersey Statute has a specific requirement for staggering of any pay-out other than on death, in that it must be on a variable basis over a period of not less than three years. While our policy is not a variable annuity, it would be necessary that we amend our form to meet such specific legal requirements for issue in the State of New Jersey.

Arizona indicated some fear that they might become involved in joint regulation with Federal Bureaus. This has been discussed with them, and we have been given verbal indication that they expect to approve it.

Indiana and Pennsylvania have acknowledged our filing with the comment that it has been referred to members of their respective staffs for study.

The District of Columbia has raised the question as to our placing a lower limit on possible policy values, without having placed an upper limit on such values as well. This part will be discussed with them.

This has necessarily become a long letter. We have attempted to approach this relatively new field cautiously and conservatively, and we appreciate your having given us the opportunity to supplement our original filing. Please let us know if you have any other questions, or if there are other facets of this operation which we should discuss.

Very cordially yours,

C. W. Buckman,
Assistant Vice President.

KB
Encs.

[Filed June 20, 1963]

[Title omitted]

DEFENDANT'S RESPONSES TO PLAINTIFF'S REQUESTS FOR ADMISSIONS

United Benefit Life Insurance Company, defendant, makes the following responses pursuant to Rule 36 of the Federal Rules of Civil Procedure to the requests for admissions served upon it by plaintiff on June 7, 1963, for the purpose of this action only, and subject to all pertinent objections to the use by plaintiff of the said responses.

1. Defendant has sold, is selling, and is about to sell to the public what the defendant designates as an "Annual Premium Flexible Fund Retirement Annuity" ("APFFRA").

R. Defendant admits the truth of the matters set forth in this request.

2. The defendant commenced the sale of APFFRA in March 1962, and as of October 17, 1962 a total of 132 APFFRA's had been sold.

R. Defendant admits the truth of the matters set forth in this request.

* * * * *

8. An interest factor is included in the determination of the "reserve" referred to in paragraph 21 of the "*Annual Premium Deferred Annuity*" policy sold by the defendant.

R. Defendant admits the truth of the matters set forth in this request.

* * * * *

23. The defendant believes that approximately one-half of the amount designated by it in "Annex 2" as "Actuarial Margin" is required to cover the estimated cost of investment management to be incurred by the defendant in respect of Flexible Fund A and to provide profits to the defendant.

R. Defendant is unable to admit or deny the truth of the matters set forth in this request for the following reasons. This request cannot be answered separately and must be considered with request numbered 24. Defendant guarantees that the only expense charge in connection with its APFFRA policy will be the amount of premium "loadings" plus the "actuarial margin," which amounts are transferred into defendant's general funds. If expenses exceed these amounts defendant and its shareholders bear the amount of the loss. Defendant estimates that investment expenses in connection with the APFFRA policy will, over the years, amount to about one half of one percent of the continuing monthly total values of the assets held in Separate Account A. Defendant also estimates that the aggregate costs, over the years, of fulfilling the mortality guarantees and the minimum cash value guarantees made by defendant will be about one-half of one percent of the continuing total asset values in Separate Account A. In the event that the total of investment expenses, mortality guarantee costs and minimum cash value guarantee costs are less than one-percent, then defendant will make a profit on this line of business if the other expenses incurred in connection with the APFFRA policies are in fact covered by the premium "loadings." Defendant does not earmark either the premium "loadings" or the actuarial margin for payment of specific expenses.

24. On the basis of studies made by it, the defendant estimates that approximately one-half of the amount designated by it in "Annex 2" as "Actuarial Margin" is required to cover the anticipated mortality costs to the defendant and the anticipated costs to the defendant of guaranteeing "minimum cash values" to be incurred as a result of defendant's sale of APFFRA.

R. The response to request numbered 23 is incorporated herein by reference as though set out verbatim, except for the second sentence thereof.

[Filed July 15, 1963]

[Title omitted]

DEFENDANT'S RESPONSES TO PLAINTIFF'S SUPPLEMENTAL REQUESTS FOR ADMISSIONS

United Benefit Life Insurance Company, defendant, makes the following responses pursuant to Rule 36 of the Federal Rules of Civil Procedure to the supplemental requests for admissions served upon it by plaintiff on June 28, 1963, for the purpose of this action only, and subject to all pertinent objections to the use by plaintiff of the said responses.

* * * * *

27. Of the total payments made by a holder of an APFFRA, the following percentages are allocated by the defendant to its "General Funds":

	First Year	Second to Tenth Years	Eleventh and Subsequent Years
Percent of Total Payments	50.0%	9.5%	5.0%
Percent of Monthly Asset Value	0.083%	0.083%	0.083%

R. Defendant admits the truth of the matters set forth in this request.

* * * * *

31. The formula for determining the "monthly accumulation rate" referred to in paragraph 12 of Exhibit A to the Complaint, is set up to reflect the investment increment during the month on those funds which were available on the first of the month.

R. Defendant denies the truth of the matters set forth in this request as stated. Defendant admits that the said formula is set up to reflect the investment increment during

the month on those assets which were present as of the first of the month, but the formula does not represent the full investment increment on assets allocated to Separate Account A because .083 per cent of the value of the assets allocated to the Separate Account A at the end of the month is transferred from Separate Account A into the defendant's general funds. Paragraph 8 of the APFFRA policy provides that premiums received on or before the 10th day of the month shall be credited as of the first day of such month. Paragraph 9 of the APFFRA policy provides that the cash value of the policy shall be the amount of accumulated value (determined in accordance with paragraphs 8 and 12 of the APFFRA policy) *but not less than* the guaranteed minimum cash value determined in accordance with said paragraph 9.

34. The "monthly accumulation rate," being based on the investment growth of assets in the "Flexible Fund A account" during the calendar month, is applied directly to the "accumulated value" of any APFFRA.

R. Defendant denies the truth of the matters set forth in this request as stated. Defendant admits that the monthly accumulation rate is based on the investment experience during the calendar month of the assets allocated to Separate Account A; and that the monthly accumulation rate is applied directly to the accumulated value of an APFFRA policy. Paragraph 9 of the APFFRA policy provides that the cash value of the policy shall be the amount of accumulated value (determined in accordance with paragraphs 8 and 12 of the APFFRA policy) *but not less than* the guaranteed minimum cash value determined in accordance with said paragraph 9.

40. The "guaranteed minimum cash values," within the meaning of paragraph 12(a) of Exhibit A attached to the Complaint, as of December 31, 1962, were in an aggregate

total of approximately $16,400, with total "accumulated values" on all outstanding APFFRA's being over $34,000.

R. Defendant admits the truth of the matters set forth in this request.

* * * * * *

44. In the course of considering the "minimum cash values" to be guaranteed in the APFFRA on a yearly basis, studies were made by appropriate departments of the defendant's staff.

R. Defendant admits the truth of the matters set forth in this request.

45. Following extended discussions based on the studies referred to in request numbered 44 above, the defendant concluded it could undertake the guarantees of the "minimum cash values" stated in paragraph 9 of Exhibit A attached to the Complaint.

R. Defendant denies the truth of the matters set forth in this request as stated. Defendant admits that following extended discussions based on such studies it was concluded that defendant could undertake the various guarantees made by defendant in the APFFRA policy.

* * * * * *

49. No contingency reserve is necessary to cover the minimum death benefit guarantee on any particular APFFRA where the cash value of such APFFRA is greater than the sum of the payments made by the purchaser thereof.

R. Defendant admits the truth of the matters set forth in this request.

50. No reserve is necessary to cover the "guaranteed minimum cash value" on any particular APFFRA where the "accumulated value" of such APFFRA is greater than the "guaranteed minimum cash value" of such APFFRA.

R. Defendant denies the truth of the matters set forth in this request. Defendant admits that no reserve, other than

the regular policy reserve, is necessary to cover the guaranteed minimum cash value on any particular APFFRA policy where the accumulated value of such APFFRA policy is greater than the guaranteed minimum cash value of such APFFRA policy.

[Filed March 17, 1965]

[Title omitted]

DEFENDANT'S MOTION TO DISMISS UNDER FEDERAL RULE OF CIVIL PROCEDURE 41(b)

The trial of this action commenced on March 15, 1965 and the plaintiff rested its case on March 15, 1965. The defendant, United Benefit Life Insurance Company, thereafter, advised the Court of its intention to file a written motion to dismiss the present action, with prejudice, and the Court directed that said written motion be filed and served on March 17, 1965, and that defendant's Memorandum of Points and Authorities in support of the motion be filed and served on Mareh 19, 1965. The present document constitutes the defendant's said written motion to dismiss.

Defendant moves the Court to dismiss the present action, with prejudice, under the Federal Rules of Civil Procedure on the ground that upon facts and the law the plaintiff has failed to show a right to relief. The plaintiff has failed to prove that the Flexible Fund Annuity policy issued by the defendant is a security within the meaning of the federal securities laws and that it is not an insurance product under the decision of *Securities and Exchange Commission* v. *Variable Annuity Life Insurance Company*, 359 U.S. 65.

DAWSON, GRIFFIN, PICKENS & RIDDELL.
By: /s/ M. JOSEPH STOUTENBURGH,
Washington Building,
Washington, D. C., 20005.

BLANK, RUDENKO, KLAUS & ROME.
By: /s/ DANIEL J. MCCAULEY, JR.,
/s/ MORRIS L. WEISBERG
1660 Suburban Station Building,
Philadelphia, Pennsylvania,
19103.

/s/ DONALD F. EVANS,
Vice President and General Counsel,
United Benefit Life Insurance Company,
Omaha, Nebraska.

Dated: March 17, 1965

[Filed April 5, 1965]

[Title omitted]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This case came on for trial, and the Court having considered the evidence, finds the facts and states its conclusions of law as follows:

Findings of Fact

1. The plaintiff is the Securities and Exchange Commission, an administrative agency of the United States charged with the administration of the federal securities laws.

2. Defendant, United Benefit Life Insurance Company, is a legal reserve, stock, life insurance company incorporated and existing under the laws of the State of Nebraska.

3. The defendant is a corporation subject to the supervision of the Director of Insurance of the State of Nebraska and of the insurance commissioner (or similar official) of the other states in which it is authorized to do business and of the District of Columbia.

4. The defendant has been, and intends to continue, offering an annuity referred to as the Annual Premium Flexible Fund Retirement Annuity (herein called the FFA policy).

5. Under the guaranteed minimum cash value provision in the FFA policy the defendant guarantees to the annuitant a fixed dollar equal monthly retirement income after the maturity date is reached which income cannot be outlived and the defendant thereby assumes the investment risk involved in that guarantee.

Conclusions of Law

1. The Court has jurisdiction over the parties and of the subject matter.

2. The issue in the present case is whether the FFA policy is a security within the definition and legislative intendment of the Securities Act of 1933 or is an "insurance

policy," "annuity" or "optional annuity contract" within the exemption provided in Section 3(a)(8) of that Act.

3. In *Securities and Exchange Commission* v. *Variable Annuity Life Insurance Company,* 359 U.S. 65 (1959), (VALIC), in deciding that the contract there involved was a security and not an "insurance product," the Supreme Court said that:

> "The difficulty is that, absent some guarantee of fixed income, the variable annuity places all the investment risks on the annuitant, none on the company. The holder gets only a *pro rata* share of what the portfolio or equity interest reflects—which may be a lot, a little, or nothing."
>
> * * * * *
>
> "The companies that issue these annuities take the risk of failure. But they guarantee nothing to the annuitant except an interest in a portfolio of common stocks or other equities—an interest that has a ceiling but no floor."
>
> * * * * *
>
> "In hard reality the issuer of a variable annuity that has no element of a fixed return assumes no true risk in the insurance sense."
>
> * * * * *
>
> "We deal with a more conventional concept of risk-bearing when we speak of 'insurance.' For in common understanding 'insurance' involves a guarantee that at least some fraction of the benefits will be payable in fixed amounts."

As is found in Paragraph 5 above, the minimum guarantee in the FFA policy does provide a guaranteed basic fixed dollar monthly equal retirement income, after the maturity data has been reached, which cannot be outlived.

The Court accordingly concludes that the FFA policy is an insurance product within the interpretation of VALIC.

4. The FFA policy, therefore, is not a security within the Securities Act of 1933.

5. Upon the facts and the law, the plaintiff has failed to show a right to the relief prayed for in the complaint. The complaint shall be dismissed.

Order

And Now this 5 day of April, 1965, it is

ORDERED, ADJUDGED and DECREED that the relief prayed for in the complaint is denied in all respects, and it is further

ORDERED, ADJUDGED and DECREED that the complaint of the plaintiff be and the same hereby is dismissed on the merits.

/s/ EDWARD M. CURRAN,
U.S. District Judge.

[Filed April 15, 1965]

[Title omitted]

NOTICE OF APPEAL

Notice is hereby given that the plaintiff, Securities and Exchange Commission, hereby appeals to the United States Court of Appeals for the District of Columbia Circuit from the order denying in all respects the relief prayed for in the complaint and dismissing the complaint of the plaintiff on the merits which order was entered in this action on April 5, 1965, and constituted a final judgment of the Court.

/s/ PHILIP A. LOOMIS, JR.,
General Counsel.
/s/ WALTER P. NORTH,
Associate General Counsel.
/s/ ROBERT L. MCCLOSKEY,
Attorney.
/s/ JACOB H. STILLMAN,
Attorney.
Securities and Exchange Commission, Washington, D.C., 20549

Copy to: M. JOSEPH STOUTENBURGH,
DAWSON, GRIFFIN, PICKENS & RIDDELL,
Washington Building,
Washington, D.C., 20005.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1965 785319 141

[fol. 109] IN THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 19382

SECURITIES AND EXCHANGE COMMISSION, Appellant,

v.

UNITED BENEFIT LIFE INSURANCE COMPANY, Appellee.

Appeal from the United States District Court for the District of Columbia

Mr. *Walter P. North,* Associate General Counsel, with whom *Mr. Philip A. Loomis, Jr.,* General Counsel, Securities and Exchange Commission, was on the brief, for appellant. *Mr. Robert L. McCloskey,* Attorney, Securities and Exchange Commission, also entered an appearance for appellant.

Mr. Daniel J. McCauley, Jr., of the bar of the Supreme Court of Pennsylvania, *pro hac vice,* by special leave of court, with whom *Mr. M. Joseph Stoutenburgh* was on the brief, for appellee.

Mr. Joseph B. Levin, with whom *Mr. Marc A. White* was on the brief, for Investment Company Institute and National Association of Securities Dealers, Inc., as *amici curiae,* urging reversal.

[fol. 110] Before BAZELON, *Chief Judge,* EDGERTON, *Senior Circuit Judge,* and BURGER, *Circuit Judge.*

OPINION—March 10, 1966

BAZELON, *Chief Judge:* The basic issue in this case is whether the Flexible Fund Annuity (FFA) issued by appellee United Benefit Life Insurance Company (United) is subject to federal regulation under the Securities Act of 1933 and the Investment Company Act of 1940. The Securities and Exchange Commission sought injunctive relief in the District Court against United on the grounds that the FFA contract is an unregistered "security" within

the definition of the 1933 Act[1] and that the separate account, which United created in connection with the FFA, is an unregistered "investment company" within the meaning of the 1940 Act.[2] The District Court ruled that the FFA was an "insurance product," exempted from regulation under both Acts.[3] This appeal followed.

The FFA contract is framed as a deferred annuity policy. The policyholder agrees to pay United a specified gross premium periodically—*i.e.*, once a month—for a certain number of years. These premiums, less deductions for expenses, are accumulated by United during this deferred period in a separate account, known as Flexible Fund A. Unlike a conventional annuity, however, United does not guarantee to accumulate net premiums at a [fol. 111] specified rate of interest. Instead, United promises that the annuitant will be credited with a proportionate share of the profits which have resulted from the investment and reinvestment of the money in the Flexible Fund. In addition, United guarantees that at least 100 per cent of the net premiums will stand to the account of the annuitant throughout the deferred period if the investment experience of the Fund is unprofitable.[4] Cash surrender values equal

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[1] 48 Stat. 74 (1933), as amended, 15 U.S.C. § 77b(1) (1964).

[2] 54 Stat. 797 (1940) as amended, 15 U.S.C. § 80a-3, (1964).

[3] The Securities Act of 1933 contains an exemption for,

> "Any insurance or endowment policy or annuity contract or optional annuity contract . . . ." 15 U.S.C. § 77c(a)(8) (1964).

The District Court did not explicitly address itself to the Investment Company Act, but implicit in its decision is a finding that the Flexible Fund fell within the exemption of that Act for "any bank or insurance company . . . ." 15 U.S.C. § 80a-3(c)(3) (1964).

[4] This assumes that the deferred period is ten years or longer. If the deferred period is less than ten years, United only guarantees a percentage of the net premiums, ranging from 50 per cent in the first year to 90 per cent in the ninth year.

to the accumulated value or minimum guarantee of the policy, and death benefits equal to the accumulated value or total gross premiums paid, whichever are higher, are also provided during the deferred period. At the maturity date specified in the policy, the annuitant is given the option of withdrawing the accumulated value of his policy in cash or of applying this value to a fixed annuity at rates prescribed in the initial contract. These rates are based upon a guaranteed 2½ per cent interest factor during the pay-out period, and once United begins payments to the annuitant the value of his policy is fixed; the profits made by the Fund are no longer accumulated in favor of the annuitant.

The result in this case, as both parties recognize, is controlled by the Supreme Court's recent decision in the *VALIC* case.[5] At issue in *VALIC* was a variable annuity policy which did not guarantee a fixed monetary value for the annuity either in the deferred or pay-out periods; its value at all times depended directly upon the investment experience of a pool of securities, and the annuitant was, in effect, a direct participant in that pool. The ques-[fol. 112] tion was whether this variable annuity was a "security" within the meaning of the 1933 and 1940 Acts or a "contract of insurance," which would be exempt from the Acts by their own terms, as well as by the provisions of the McCarran-Ferguson Act.[6] The majority of the Court found that the issuing company had assumed the mortality and expense risks usually associated with insurance. However, since the company did not guarantee a fixed monetary value for the policy, it placed "all of the investment risk on the annuitant, none on the company." Because the concept of insurance required "some investment risk-taking on the part of the company," the Court concluded that the variable annuity was not "insurance" and hence was subject to federal regulation.

In a concurring opinion, Mr. Justice Brennan explained in greater detail why the factor of investment risk was determinative. He pointed out that the purpose of the

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[5] *SEC* v. *Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959).

[6] 59 Stat. 33 (1945), as amended, 15 U.S.C. § 1011 (1964).

federal regulatory scheme had only minimal relevance to conventional insurance and annuity policies, which assumed the investment risk by creating fixed monetary obligations, and that state regulation of reserves and solvency offered truly meaningful protection to the policyholder. Mr. Justice Brennan reasoned that since the variable annuity in *VALIC* did not include substantial fixed dollar guarantees, federal regulation was quite relevant to the variable annuity contract, while state regulation was not; he therefore found the contract a "security," subject to the 1933 and 1940 Acts. In sum, both the majority and concurring opinions implicity held that a company must bear a substantial part of the investment risk associated with the contract, as well as the mortality and expense risks, in order to qualify its products as "insurance."

In most respects the FFA and the traditional deferred [fol. 113] annuity are identical. Both guarantee interest on principal during the pay-out period; both assume all mortality and expense risks throughout the term of the contract; and both provide death benefits and cash surrender values.[7] The only meaningful difference between the FFA and the conventional deferred annuity is that the FFA does not guarantee interest on the accumulation of net premiums during the deferred period, but instead promises 100 per cent of net premiums plus a share in any profits made by the investment and reinvestment of the money in the Flexible Fund.

The SEC would minimize the similarities between the FFA and the deferred annuity first by asserting jurisdiction only over the deferred portion of the contract. The SEC then contends that the "investment risk" referred to in *VALIC* is the risk of not earning interest on the principal sum invested and that a contract is not "insurance"

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[7] For a general description of the conventional deferred annuity see, *e.g.*, HUEBNER & BLACK, LIFE INSURANCE 104-16, 311-22, 329-30, 332-34 (6th ed. 1964) [hereinafter cited as HUEBNER & BLACK]; MEHR & OSLER, MODERN LIFE INSURANCE 79-103, 531-47 (3rd ed. 1961) [hereinafter cited as MEHR & OSLER].

unless interest as well as principal is guaranteed. In support of this position the SEC emphasizes the extent to which the fortunes of the annuitant depend upon the investment policies and experience of the Fund and argues that the court should not treat the minimum guarantee of 100 per cent of net premiums as a substantial assumption of investment risk because it is extremely unlikely that the Fund's investment experience will be so disastrous as to call the guarantee into effect.

We note initially that adoption of the SEC's position that interest must be guaranteed during the deferred, as well as the pay-out period would restrict annuity policies essentially to their current form. This result would con- [fol. 114] travene the explicit warning of the Supreme Court in *VALIC* where all nine Justices counseled against freezing the concept of annuity into a single pattern and argued that development and growth of insurance concepts should be allowed.[8] We also think that the SEC has misconceived the concept of "investment risk," as it is used in *VALIC*, by focusing on the likelihood of United's having to make good on its guarantee. Presumably no insurance company will undertake a guarantee in any policy if there is a substantial possibility that it will have to resort to surplus to satisfy that obligation.[9] Instead of denoting the company's risk, we think the concept refers to the annuitant's risk of losing money—principal, as well as anticipated earnings on principal—over the course of the investment period. By guaranteeing principal—100 per cent of net premiums—United has assumed a substantial part of this risk during the deferred period of the contract. Were the annuitant to invest on his own in the stock market, or even in so-called "safe" securities like

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[8] 357 U.S. at 68, 71, 75-76, 100-01.

[9] If an insurance company guarantees 2 per cent or 3 per cent interest, it does so only after it has made extensive studies which demonstrate to its satisfaction that there is no substantial probability that the funds associated with the policy will fail to earn this amount over the duration of the contract. See, *e.g.*, HUEBNER & BLACK 296-300, 346-47, 388-90; MEHR & OSLER 590-93, 599.

bonds and mortgages, he would not have this guarantee, and his principal would never be absolutely secure.[10]

[fol. 115] Finally, we reject the SEC's basic premise that the contract should be fragmented and the risk during the deferred period only should be considered. United's guarantee of principal and 2½ per cent interest during the pay-out period is a very substantial assumption of investment risk, which should not be ignored. Indeed, the *VALIC* opinions, as well as common sense, indicate that a challenged policy should be viewed as a whole in order to test its amenability to federal regulation. All told, United has assumed not only a substantial part, but by far the major part, of the investment risk over the duration of the entire policy.[11] The obligations of United under the FFA, unlike

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[10]The SEC also urges that so long as the contract allows the annuitant any direct participation in the investment experience of the company, the policy must be subject to the federal regulatory scheme. This argument ignores completely the language and logic of *VALIC*, which contemplated a test based on the substantiality of the investment risk assumed by the company. See 359 U.S. at 71-73, 88, 89. A related objection to this argument is the effect that it would have upon the participating annuity, which the SEC concedes is exempt from federal regulation. The participating annuity clearly provides, and is intended to provide, that the annuitant will participate directly, even if minimally, in the investment experience of the company. See, *e.g.*, HUEBNER & BLACK 387-98; MEHR & OSLER 598-605; 614-20.

[11]The substantiality of the investment risk which United assumes in the FFA is even more apparent when that policy is compared with a participating annuity. In the latter, the interest factor during the deferred period is deliberately set quite low so as to assure dividends; and while dividends are in theory discretionary, in practical terms they must be declared regularly or the company will lose too much business. In effect, a participating policy promises, in part, a smaller interest guarantee in return for the opportunity to share in greater interest when that is earned. See, *e.g.*, HUEBNER & BLACK 387-402; MEHR &

those of the variable annuity, are stated, in large part, in terms of guaranteed dollar amounts; there is a substantial and meaningful "floor" to the FFA policy. We therefore conclude that the FFA is an "insurance" contract and as [fol. 116] such beyond the scope of federal regulation under the 1933 and 1940 Acts.[12] The judgment of the District Court is

Affirmed.

OSLER 598-605, 614-20. For this reason the FFA can be regarded as an extension or development of the concept of participating insurance.

[12] The SEC finally contends that the case should be reversed because of the trial court's rulings on admission of evidence. Whether or not these rulings were correct, we don't think they affected "substantial justice." FED.R. CIV.P. 61.

[fol. 117] [File endorsement omitted]

IN THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Civil 3096-62

No. 19,382 September Term, 1965.

SECURITIES AND EXCHANGE COMMISSION, Appellant,

v.

UNITED BENEFIT LIFE INSURANCE COMPANY, Appellee.

Appeal from the United States District Court for the District of Columbia

Before: Bazelon, Chief Judge, Edgerton, Senior Circuit Judge, and Burger, Circuit Judge.

JUDGMENT—March 10, 1966

This cause came on to be heard on the record on appeal from the United States District Court for the District of Columbia, and was argued by counsel.

On consideration whereof it is ordered and adjudged by this Court that the judgment of the District Court appealed from in this cause be, and it is hereby, affirmed.

Per Chief Judge Bazelon.

[fol. 118] CLERK'S CERTIFICATE TO FOREGOING TRANSCRIPT OMITTED IN PRINTING.

[fol. 119] SUPREME COURT OF THE UNITED STATES,
OCTOBER TERM, 1965

No.—

SECURITIES AND EXCHANGE COMMISSION, Petitioner,

vs.

UNITED BENEFIT LIFE INSURANCE COMPANY.

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI—June 9, 1966

UPON CONSIDERATION of the application of counsel for petitioner(s),

IT IS ORDERED that the time for filing a petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including July 8th, 1966.

Earl Warren, Chief Justice of the United States.

[fol. 120] SUPREME COURT OF THE UNITED STATES,
OCTOBER TERM, 1966

No.—

SECURITIES AND EXCHANGE COMMISSION, Petitioner,

vs.

UNITED BENEFIT LIFE INSURANCE COMPANY.

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI—July 7, 1966

UPON CONSIDERATION of the application of counsel for petitioner(s),

IT IS ORDERED that the time for filing a petition for writ of certiorari in the above-entitled cause be, and the same is hereby, further extended to and including August 8, 1966.

Potter Stewart, Associate Justice of the Supreme Court of the United States.

[fol. 121] SUPREME COURT OF THE UNITED STATES,
OCTOBER TERM, 1966

No. 428

SECURITIES AND EXCHANGE COMMISSION, Petitioner,

vs.

UNITED BENEFIT LIFE INSURANCE COMPANY.

ORDER ALLOWING CERTIORARI—October 24, 1966

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit is granted, and the case is placed on the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1966—239-893/405